



209-256-1371 Fax 209 231-3855

Prepared By

C. Fred Hall III, MBA, CBA, CVA

HiTech Precision Sheetmetal, Inc.

**999 Anystreet
Silicon Valley, CA 95134**

Business Valuation

April 1, 2015



Confidential



EXECUTIVE SUMMARY

The appraisal assignment called for determining the Fair Market Value of a 100% interest in HiTech Precision Sheetmetal, Inc. as of December 31, 2014. The valuation of the 100% interest in the Subject Company is on a controlling, non-marketable basis.

HiTech Precision Sheetmetal, Inc. was established in 1999 by John Smith and his wife, Jane Smith. The company was incorporated September 19, 2000. HiTech Precision Sheetmetal, Inc. is presently an S-Corporation which is 50% owned by John Smith and 50% owned by Jane Smith. The business is a contract sheetmetal fabricator. Approximately 59% of the company's gross revenues in 2014 were from Google. Another 29% were to Mobile Materials. The products fabricated for Mobile Materials were assembled into components that Mobile Materials shipped to Google. Revenues and net income for the last six accounting periods are as follows:

	2014	2013	2012	2011	2010	2009
Revenues	15,555,595	16,601,655	16,562,358	15,783,354	14,757,942	7,860,398
Net Income	\$1,906,228	\$2,455,756	\$383,825	\$719,301	\$1,018,070	(\$1,208,754)

Two different methodologies were employed in the valuation – the Income Approach and the Market Approach. The Market Approach used four different procedures to estimate the Subject's Fair Market Value. These four procedures produce a value known as an Asset Sale Value. An Asset Sale, which is the most common format for a small business transaction, only includes the company's inventory (if any), fixtures and equipment, and all its intangibles. The Seller would retain the entity, all cash and accounts receivable, and, pay off all liabilities. In order to determine the value of the Subject's net worth, the Asset Sale Value must be further reconciled to account for the additional assets and liabilities that were *not* included in a conventional Asset Sale. The result will be the Fair Market Value of HiTech's Net Worth.

Reconciliation of Asset Sale to Total Adjusted Equity Value				
Procedure	Revenue Multiplier	Cash Flow Multiplier	Enterprise Multiplier	Regression
Asset Sale Value	\$8,631,512	\$9,632,511	\$7,359,909	\$7,087,901
Balance Sheet Adjustments	1,013,417	1,013,417	1,013,417	1,013,417
Total Equity Value	\$9,644,929	\$10,645,928	\$8,373,326	\$8,101,318

Each of the Market Approach procedures developed a different value for the Subject. This is a normal occurrence since each procedure focuses on different aspects of the Company's operations. Each procedure employed a regression analysis to predict the value of the business. The regressions produce a statistical rating known as R Squared which measures the accuracy of each procedure. A rating of 1.0 means the regression exactly predicted the value of the

business, whereas a rating of 0.0 means the regression had no predictive ability. The final reconciliation of value will weigh the different procedures according to their R Squared rating.

The Income approach incorporates all the balance sheet and income statement elements of a business, along with projections of future revenue. Thus, it is considered a more comprehensive methodology. Hence, it is given a 50% weighting in the final conclusion of value. (For a discussion on the weightings see the Summary on Page 96.)

The Income Approach bases the value of the operating assets of a company on its ability to generate cash. Implicit in the approach is that a buyer will look at the cash flow a company generates, apply a desired rate of return, and thereby determine an appropriate amount to invest in the company.

The methodology used is referred to as the Single Period Capitalization Method. The basic assumption underlying this method is that a single year's projected cash flow can serve as a proxy for all future cash flow because there are no expectations of unusual events or non-recurring income or expenses.

In my opinion, using accepted methodologies of valuation, and, subject to the assumptions and limiting conditions set forth in this report, the Fair Market Value of a 100% interest in the Net Worth of HiTech Precision Sheetmetal, Inc. as of December 31, 2014 is:

Procedure	Summary of Net Equity Values by Methodology				
	Market Approach (Page 94 to 96)				Income Approach (Page 60)
	Revenue Multiplier	SDE Multiplier	Enterprise Multiplier	Regression	
Asset Sale Value	\$7,133,481	\$7,960,753	\$6,082,570	\$5,857,769	
Balance Sheet Adjustments	<u>\$1,013,417</u>	<u>\$1,013,417</u>	<u>\$1,013,417</u>	<u>\$1,013,417</u>	
Total Net Worth Value - 100% Interest	\$8,146,898	\$8,974,170	\$7,095,987	\$6,871,186	\$6,432,000
Adjustment for DLOM (1 - 8%)	None	None	None	None	x 92%
100% Controlling, Non-mktble Interest	\$8,146,898	\$8,974,170	\$7,095,987	\$6,871,186	\$5,917,440
Weightings	x 18.1%	x 4.60%	x 1.4%	x 25.9%	x 50.0%
Net Weighted Values	\$1,474,589	\$412,812	\$99,344	\$1,779,637	\$2,958,720
* Total Weighted Value of a 100% Interest (Rounded)				\$6,730,000	
Six Million Seven Hundred Thirty Thousand Dollars					

The above value is for a 100% interest in the Net Worth of HiTech Precision Sheetmetal, Inc. on a controlling, non-marketable basis as of December 31, 2014.

Appraiser's Certificate

- 1) *The statements of fact contained in this report are true and correct to the best of my knowledge and belief, subject to the assumptions and conditions stated.*
- 2) *The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions and are my personal, unbiased and professional analyses, opinions, and conclusions.*
- 3) *I have no present or prospective interest in the property that is the subject of this report, nor is my compensation dependent upon the value of this report or contingent upon producing a value that is favorable to the client.*
- 4) *I have no personal bias with respect to the parties involved nor have I made a full disclosure of any such bias.*
- 5) *This appraisal has been conducted and the report was written in conformity with the Business Appraisal Standards of the Institute of Business Appraisers.*
- 6) *No person except the undersigned participated materially in the preparation of this report.*

Sincerely,



C. Fred Hall, III, MBA, CBA, CVA

April 1, 2015

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1.0 INTRODUCTION

1.1 REPORT DATE: APRIL 1, 2015

1.2 DATE OF VALUATION: DECEMBER 31, 2014

1.3 SUBJECT OF APPRAISAL

The subject of this business appraisal is HiTech Precision Sheetmetal, Inc., located at 1015 Anystreet Drive, Silicon Valley, CA 95133. The company, which is an S-Corporation, is 50% owned by John Smith and 50% owned by Jane Smith. A site inspection was performed by the Appraiser on March 31, 2015.

1.4 PURPOSE AND USE

The purpose of the appraisal is to determine the fair market value of a 100% ownership interest in the net worth of HiTech Precision Sheetmetal, Inc. on a controlling, non-marketable basis. "Marketability is defined as the ability to convert the investment into cash very quickly at a minimum cost and with a high degree of certainty of realizing the anticipated amount of proceeds."¹ Since ownership in small, privately held companies generally cannot be converted into cash quickly, such investments are referred to as non-marketable. In other words, the Subject interest is non-marketable and, therefore, will be valued on a non-marketable basis.

The report is intended solely for the use of John Smith, who engaged the Appraiser, to be used for planning an exit strategy.

1.5 STANDARD OF VALUE

IRS Revenue Ruling 59-60 defines Fair Market Value as "the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state, in addition, that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade, and to be well informed about the property and concerning the market for such property."²

Revenue Ruling 59-60 also gives us guidance as to what factors should be considered. These are summarized below:³

- 1) The nature of the business and the history of the enterprise from its inception;
- 2) The economic outlook in general and the condition and outlook of the specific industry in particular;

¹ Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweih, Valuing a Business: The Analysis and Appraisal of Closely Held Companies, 4th edition (New York, NY: McGraw-Hill, 2000), p. 26

² Internal Revenue Service, Revenue Ruling 59-60, (1959), Section 2, p.1
http://www.hantzmonwiebel.com/live_data/documents/ruling-59-60.pdf

³ Ibid., p.2ff

- 3) The book value of the stock and the financial condition of the business;
- 4) The earning capacity of the company;
- 5) The dividend-paying capacity;
- 6) Whether or not the enterprise has goodwill or other intangible value;
- 7) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter;
- 8) The marketability, or lack thereof, should be considered when valuing controlling interests and non-controlling interests.

As such we will give consideration to the following:

- 1) Under the premise of a going concern, the business will continue to operate in the future rather than be liquidated;
- 2) The transaction is at “arms-length” between a hypothetical buyer and seller and the buyer has an expectation of earning a fair return on his investment;
- 3) The hypothetical purchaser is assumed to be a financial buyer rather than a strategic buyer. Under the standard of Investment Value (as opposed to the standard of Fair Market Value), a strategic buyer is a known individual or company that has unique opportunities to gain from the acquisition. For example, by acquiring the target company the strategic buyer would be able to eliminate the competition in his market. Strategic buyers often are willing to pay a premium over the Fair Market Value because of such one-of-a-kind opportunities. As of the valuation date, there were no known strategic buyers who made any offers for the Subject Company, and as such, no potential premium under the standard of Investment Value can be determined;
- 4) The seller is also assumed to be hypothetical and is one who is informed about the market for such investments and the effects of the unattractive characteristics of the Subject due to its lack of control and lack of marketability;
- 5) The subject will be sold for cash or a cash equivalent; and,
- 6) The business will be held on the open market for a reasonable length of time.

1.6 PREMISE OF VALUE

Going Concern

The underlying premise assumed here is that the business will continue to operate in the future as it has in the past which, therefore, gives rise to an intangible value for its name, reputation,

location, or unique manner of doing business. The earning power of the enterprise and its ability to continue generating cash flow in the future are indicators of Fair Market Value.

1.7 ASSUMPTIONS AND LIMITING CONDITIONS

When valuing a business the appraiser must make certain assumptions. These assumptions and various limiting conditions will have a significant impact on the conclusion of value of the company being appraised. The following are assumptions and conditions affecting this valuation.

1.7.1 The valuation process is not specifically a fact-finding mission. The appraiser's opinion is supported by research and analysis, but the valuation conclusion ultimately reflects his informed and unbiased judgment.

1.7.2 Interviews with principals of the Subject were conducted by the Appraiser using the Appraiser's questionnaires. The Appraiser has relied on the representations of management without independent investigation. The information was obtained in good faith but no opinion or warranty is implied or expressed by the Appraiser.

1.7.3 This report cannot be relied upon to disclose any fraud, misrepresentation, or deviation from Generally Accepted Accounting Principles.

1.7.4 This report is to be used for the expressed purpose stated above. Any other use is prohibited and invalidates the conclusions of this appraisal.

1.7.5 The appraiser assumes no responsibility for any legal or tax matters that are relative to the findings of this report.

2.0 ECONOMIC FACTORS AND COMPANY ANALYSIS

2.1 HOW THE ECONOMY AFFECTS VALUE

The economy has a direct effect on all businesses. The GDP (Gross Domestic Product), which is a measure of growth of the economy, is made up of three components: 1) personal disposable income and the resulting consumption; 2) business investments (plant and equipment and inventory); and, 3) government spending. The end users of HiTech's products are other businesses. Thus, the level of corporate profits and household income and unemployment rates, which are trailing indicator of business activity, are of the utmost importance. By tracking the movement of the GDP, household income, unemployment, and corporate profits as well as developing projections for their growth in the future, we should be able to gain insight into HiTech's growth potential.

The following is an assessment of these and other economic factors and their influence on the Subject Company's operations.

2.2 CURRENT U.S. ECONOMIC OUTLOOK^{4,5}

The Conference Board reported that the Leading Economic Index continued its upward trend in December. The gains among the index's components continued to be widespread, suggesting that the short-term outlook is getting brighter and the economy continues to build momentum.

Consumer optimism rose notably in December. The Conference Board reported that its Consumer Confidence Index increased, and consumers' perceptions of current conditions improved to its highest level since February 2008. The Thomson Reuters/University of Michigan's Consumer Sentiment Index also rose, reaching its highest reading since July 2007. The report found that consumers held the most favorable attitudes toward the long-term prospects for the economy than at any other time in the past 10 years.

The outlook also improved for small business. The National Federation of Independent Business reported that the Small Business Optimism Index rose to its highest reading since October 2006. Gains in the components that comprise the index were widespread. Further, The Wells Fargo/Gallup Small Business Index climbed to its highest reading in more than six years. Strong growth came from the component that measures small-business owners' future expectations.

Total retail sales fell 0.9% in December, lower than even the most pessimistic forecast in a Bloomberg survey of economists. While the decline was disappointing, it followed large-enough gains at the start of the quarter that signaled consumer spending accelerated from the previous three months.

Job growth continued in December, with employment gains now exceeding 200,000 jobs a month for 11 straight months, the longest stretch since March 1995. The unemployment rate also fell to a six-and-a-half-year low, though some of the decline was attributable to people leaving the workforce. Average hourly earnings declined in December, though they remained above their levels from one year ago.

The Institute for Supply Management's manufacturing sector index slipped in December for the second consecutive month. Regardless, the data indicated that the manufacturing sector expanded for the 19th consecutive month and the overall economy grew for the 67th consecutive month.

The Institute for Supply Management's index for the services sector fell in December for the third time in four months. Despite the index's retreat, the December index reading indicated that the services sector has now grown for the 59th consecutive month.

⁴ Part of the contents of the Current Economic Outlook section of this valuation report are quoted from *Economic Outlook Update, December 2014*, Business Valuations Resources, LLC, reprinted with permission. The editor and author of the report caution that the information in the report should not be interpreted as advice for the preparation of valuations or other financial counseling. Usage and application are the sole responsibility of the appraiser.

⁵ "Economic Outlook Update", Pratt's Stats Private Deal Update-3Q 2014, Business Valuation Resources, Portland OR, p.21

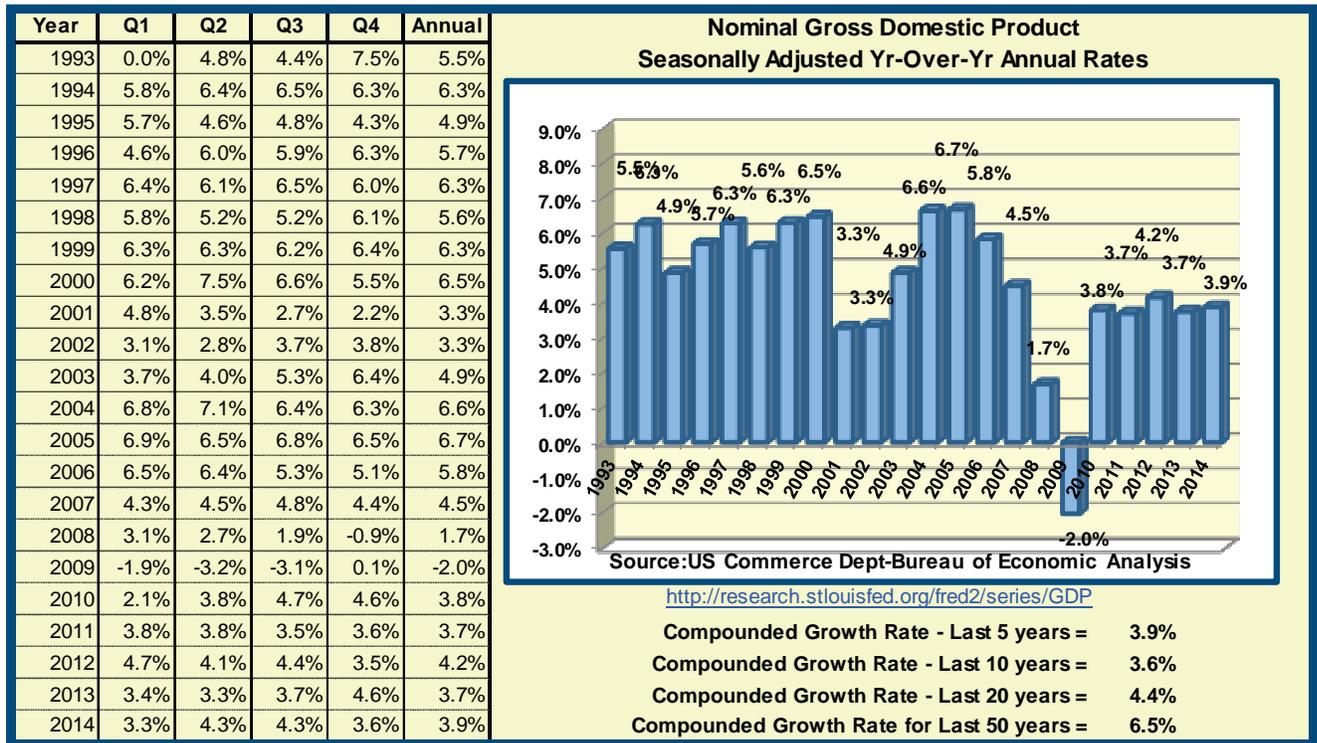
The Federal Reserve reported that industrial production fell in December but grew at an annual rate of 5.6% in the fourth quarter. Increases in manufacturing output and mining output were tempered by a marked drop in utilities, as warmer-than-usual temperatures reduced the demand for heating in December.

Both the Consumer Price Index and the Producer Price Index fell in December. Consumer prices experienced their sharpest drop since December 2008, while producer prices had their largest fall since October 2011. A sharp decline in the price of gas brought both indexes down.

Housing starts advanced in December, while authorized building permits retreated. Housing starts and authorized building permits remain above their levels from one year ago.

Nominal GDP (actual GDP including inflation) for the first quarter of 2014 declined from the prior quarter by an 0.8% annualized rate. However, year-over-year gains were still a modest 3.3%. Harsh weather during the first quarter was generally blamed for the decline. As expected, when the sun came out in the second quarter nominal GDP rebounded at a 4.3% annual rate. Third quarter nominal GDP continued the robust growth rate of 4.3%; however, by the fourth quarter growth dipped to 3.6%.

Exhibit I Nominal Gross Domestic Product - 1993 to 2014



2.2.1 UNEMPLOYMENT

The U.S. Department of Labor reported that job creation continued in December, with 252,000 new jobs being created. Employment gains have now exceeded 200,000 jobs a month for 11 straight months, the longest stretch since the 19 months that ended in March 1995. Job growth

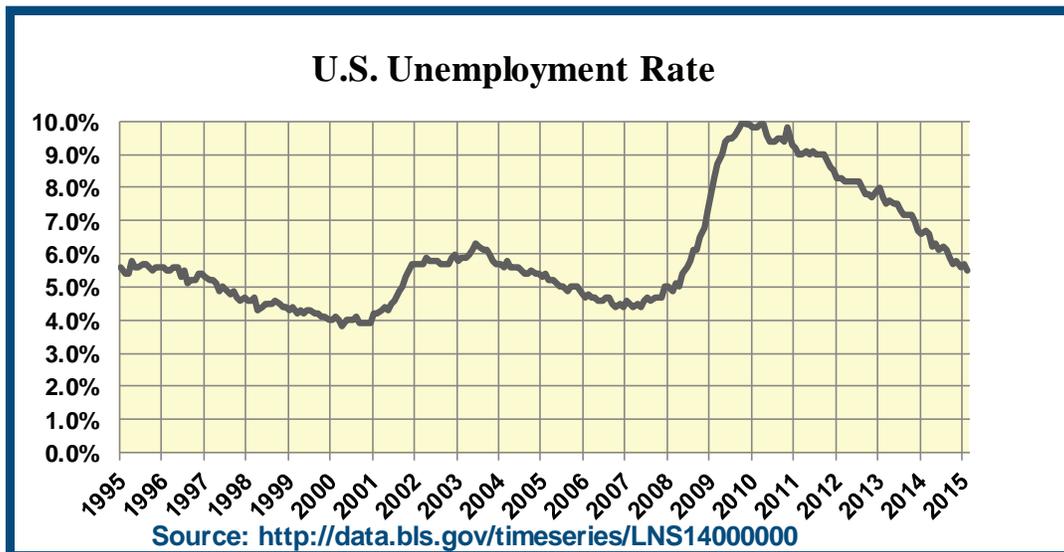
averaged 246,000 per month in 2014, compared with an average monthly gain of 194,000 in 2013. Total employment rose by 2.95 million in 2014, the most in any calendar year since 1999.

In December, employment increased in professional and business services, construction, food services and drinking places, healthcare, and manufacturing. The December employment report showed that job gains in both October and November were revised upward. With those revisions, employment gains in those two months were 50,000 greater than previously reported.

The unemployment rate (also known as the U3 unemployment rate) fell 0.2 percentage point to a six-and-a-half-year low of 5.6% in December. The annual average unemployment rate fell 1.2 percentage points between 2013 and 2014, the largest such decline since 1984. The number of unemployed persons declined by 383,000 in December to 8.7 million. In 2014, the number of unemployed persons declined by approximately 1.7 million. The U3 unemployment rate is the official unemployment rate per the International Labour Organization definition and occurs when people who have actively looked for work within the past four weeks are still without jobs.

The labor-force participation rate edged down 0.2 percentage point in December to 62.7%. The labor-force participation rate has remained within a narrow range of 62.7% to 62.9% since April. The employment-population ratio—the share of the working-age population with a job—was unchanged in December for the third consecutive month at 59.2%. However, the employment-population ratio rose by 0.6 of a percentage point in 2014.

Exhibit II Monthly Unemployment Rate - 1993 to 2014



The number of unemployed persons who have been out of work for 27 weeks or more was essentially unchanged in December at 2.8 million, or 31.7% of the total unemployed. Over the past 12 months, the number of long-term unemployed has declined by 1.1 million. The average

unemployment duration decreased slightly in December to 32.8 weeks from 33.0 weeks in November.

2.2.2 RETAIL SALES AND CONSUMER SPENDING

The U.S. Census Bureau announced that total retail and food service sales plummeted 0.9% in December, after rising 0.4% in November. Total retail sales for the period from October 2014 to December 2014 were up 4.1% from the same period a year ago. Retail sales in December were up 3.2% from a year earlier, and total sales for the 12 months of 2014 were up 4.0% from 2013. Economists view retail sales as a key economic indicator since consumer spending accounts for nearly two-thirds of the U.S. economy.

Bloomberg's survey of economists found the median expectation for retail sales was a decline of only 0.1% in December. The actual decline of 0.9% in December was below even the most pessimistic forecast in the survey (a drop of 0.5%).

Bloomberg noted that the large December drop in sales prompted economists to lower spending and growth forecasts. Morgan Stanley and JPMorgan Chase & Co. were among firms who reduced their tracking estimates for fourth quarter consumer spending. Economists at Morgan Stanley lowered their forecast for purchases to 4.1% from 4.4%, while JPMorgan modified its projection to 4.3% from 4.7%.

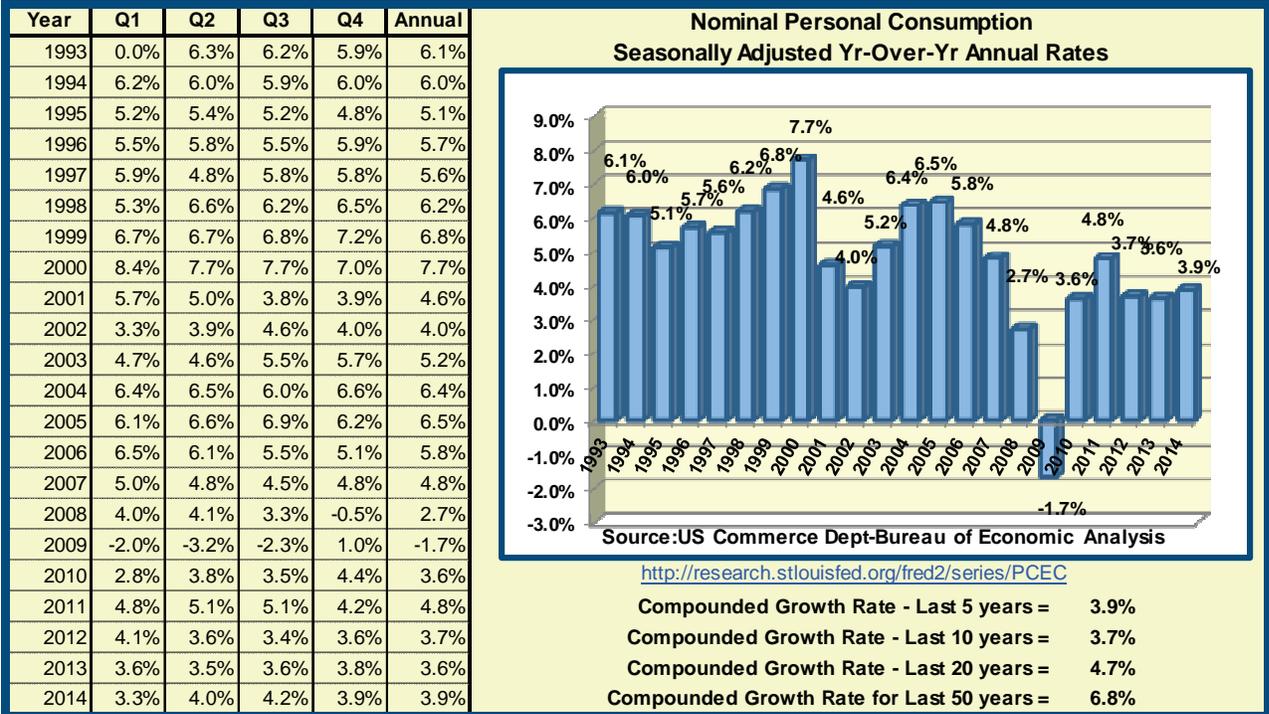
Nine of the 13 major retail categories experienced sales declines in December. The largest sales decrease came from gas stations (-6.5%), as falling gas prices pushed receipts at gas stations down by the most in six years. Sizable declines also came from miscellaneous retail stores (floral, office, pet, etc.), which fell 1.9%; building and gardening stores, which slipped 1.9%; and general merchandise stores (includes department stores), which moved down 0.9%. The category with the largest decline from one year ago was gas stations, with sales down 14.2%.

The categories that rose in December were restaurants and bars (+0.8%), furniture and home furnishing (+0.8%), health and personal care (0.5%), and food and beverage stores (groceries and liquor) (+0.3%). The category with the largest increase in sales from one year ago was automobile and parts dealers, with sales up 8.6%.

The core retail sales figure slipped 0.4% in December after rising 0.6% in November. Regardless, core retail sales remained up 3.2% from one year ago. The core retail sales figure excludes sales of automobiles, gasoline, building materials, and food services and corresponds most closely with the consumer-spending component of gross domestic product.

Personal Consumption, which includes retails sales and other consumer goods and services, began 2014 at a weak 3.3% growth rate. Poor weather in many parts of the country was

Exhibit III Personal Consumption - 1993 to 2014



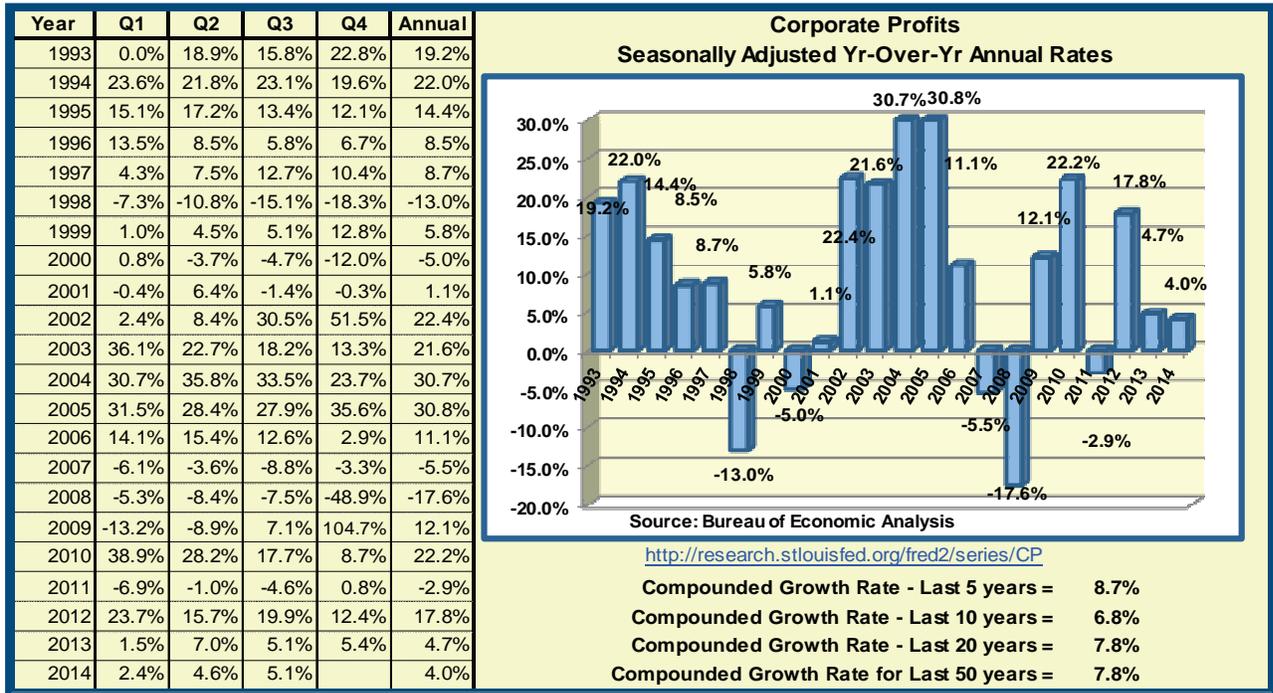
considered to be the main factor. The second quarter saw growth rebound to a 4.0% followed by 4.2% in the third quarter. By year end, the consumer pulled back somewhat with growth in personal consumption rising at a 3.9% rate.

2.2.3 CORPORATE PROFITS

All of HiTech’s revenues are generated from the sale of sheet metal components used by other manufacturers to produce products used by other businesses. Thus, corporate profits are a significant driver for this product line. As company profits increase, the need for additional fixtures, equipment, and computer equipment also increases.

As we can see from Exhibit V Corporate profits are also very volatile. They began declining in 2007 and didn’t return to positive growth until mid-2009. Following the recession, the year 2010 companies enjoyed a solid rebound in earnings, increasing 22.2%. However, the next year saw a decline of 2.9% which, in turn, was followed by a 17.8% gain in 2012. After the budget and sequester issues were resolved by congress in January 2013, the growth rate of corporate profits steadily increased throughout the remainder of the year. Yet, growth averaged just 4.7% for the entire year 2013. Thus far, corporate profits in 2014 continue to grow, albeit, a much slower rate, ranging from 2.4% to 5.1% throughout the year.

Exhibit IV Corporate Profits - 1993 to 2014



2.2.4 DURABLE GOODS MANUFACTURING

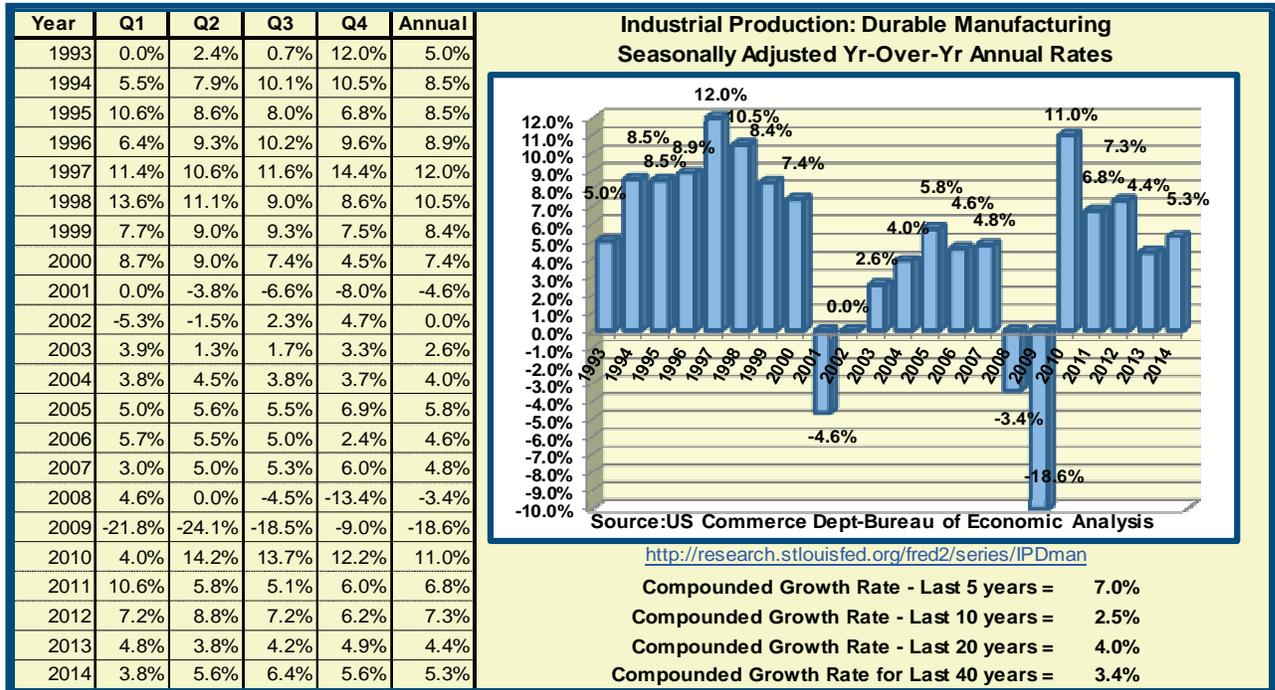
HiTech is a manufacturer of durable goods made of sheet metal. Its products are used in the manufacturing process by other downstream manufacturers. The end products produced by these downstream companies are largely within the computer and electronics sector of the economy.

The manufacturing sector in general has enjoyed a string of gains following the recession. The Institute for Supply Management (ISM) reported that its Manufacturing Index (PMI) moved down 3.2 percentage points in December to 55.5%. PMI is an indicator of the economic health of the manufacturing sector and is based on data compiled from purchasing and supply executives nationwide. Of the 18 manufacturing sectors surveyed in December, 11 reported growth. The comments from the panel were mixed. Some indicated that falling oil prices had benefited business, while others said it hurt business. Other comments mentioned the negative impact on imported materials shipment due to the West Coast dock slowdown.

The report noted that, based on the past relationship between PMI and the overall economy, the average PMI for January through December (55.8%) corresponds to a 4.2% increase in real GDP on an annualized basis. In addition, if the PMI for December (55.5%) were annualized, it would correspond to a 4.1% increase in real GDP annually. A reading above 50% indicates that the manufacturing economy is generally expanding; a reading below 50% indicates that it is generally contracting. A PMI in excess of 42.5%, over a period of time, generally indicates an expansion of the overall economy. Therefore, the December PMI indicates an expansion in

the manufacturing sector for the 19th consecutive month and growth in the overall economy for the 67th consecutive month.

Exhibit V Durable Goods Manufacturing - 1993 to 2014



2.2.5 ECONOMIC OUTLOOK⁶

The most recent release of *The Livingston Survey* (the *Survey*) predicts fairly steady output growth through the end of 2015. The *Survey*, conducted by the Federal Reserve Bank of Philadelphia, is the oldest continuous survey of economists' expectations. It summarizes the forecasts of economists from industry, government, banking, and academia. The participants project real GDP to grow at an annual rate of 2.9% in the first half of 2015 and 2.7% in the second half of 2015. They believe GDP will grow 2.5% annually over the next ten years.

The *Survey* forecasted the unemployment rate to be 5.6% in June 2015, before declining to 5.4% in December 2015.

The forecasters in the *Survey* expect consumer price inflation (CPI) to be 1.4% in 2015 and 2.1% in 2016. The *Survey* expects CPI to average 2.3% over the next ten years. The *Survey* expects producer price inflation (PPI) to be 1.1% in 2015 and 1.5% in 2016.

The *Survey* predicts the interest rate on three-month Treasury bills will be 0.25% at the end of June 2015. The forecasters predict that the rate will increase to 0.81% in December 2015 and 2.25% in December 2016. They predict the interest rate on 10-year Treasury bonds will reach

⁶ Business Valuations Resources, LLC, "Pratt's Stats Private Deal Update – 4Q 2014," Pg 21

2.72% at the end of June 2015. According to the *Survey*, the rate will then rise to 3.20% in December 2015 and 3.75% in December 2016.

The forecasters from the *Survey* have increased their previous projections for future S&P 500 values. They expect the S&P 500 will climb to 2,125.0 by the end of June 2015, before rising to 2,160.6 by the end of December 2015 and 2,300.0 at the end of December 2016.

	HISTORICAL DATA											CONSENSUS FORECASTS**						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020-2024	
Real GDP*	3.8	3.3	2.7	1.8	-0.3	-2.8	2.5	1.6	2.3	2.2	2.3	3.0	3.0	2.8	2.6	2.4	2.4	
Industrial production*	2.3	3.2	2.2	2.5	-3.4	-11.3	5.7	3.3	3.8	2.9	4.0	3.5	3.4	3.1	2.8	2.8	2.6	
Personal consumption*	3.8	3.5	3.0	2.2	-0.3	-1.6	1.9	2.3	1.8	2.4	2.3	2.8	2.8	2.6	2.5	2.3	2.3	
Nominal pretax corp. profits*	21.5	15.1	11.4	-7.1	-16.0	8.4	25.0	4.0	11.3	4.2	0.0	7.3	4.3	3.1	3.2	3.5	4.4	
Unemployment rate	5.5	5.1	4.6	4.6	5.8	9.3	9.6	8.9	8.1	7.4	6.2	5.5	NA	NA	NA	NA	NA	

Source of historical data: U.S. Department of Commerce, U.S. Department of Labor, U.S. Census Bureau and The Federal Reserve Board.
 Source of forecasts: *Consensus Forecasts - USA*, December 2014.

Notes:
 *Numbers are based on percent change from preceding period.
 Historic consumer price inflation, unemployment rate, 3-month Treasury rate, and 10-year Treasury yield are the annual averages.
 **Forecast numbers are based on percent change from preceding period (excludes unemployment rate, housing starts, 3-month Treasury rate, and 10-year Treasury yield). Consumer price inflation information is annual averages. The 2014 through 2019 forecasts for the 3-month Treasury rate and 10-year Treasury yield are for the end of each period. Forecasts for 2020-2024 signify the average for that period.
 Personal consumption includes spending on services, durable, and nondurable goods.
 Nonresidential fixed investment is also known as business spending.
 Total government spending includes federal, state, and local government spending.
 Every month, Consensus Economics surveys a panel of 30 prominent United States economic and financial forecasters for their predictions on a range of variables including future growth, inflation, current account and budget balances, and interest rates.

2.3 INDUSTRY ANALYSIS

2.3.1 INDUSTRY CHARACTERISTICS.⁷

A significant proportion of HiTech products are generally incorporated into larger capital equipment products that are used in the computer and electronics industry. From small component manufacturers such HiTech to the end-producers of semiconductor chipsets such as Intel, all are chained together in that they are all affected by the cyclical nature of the semiconductor and electronics industry. The \$250 billion industry generates over \$1.2 trillion in electronic systems business and \$5 trillion in related services which represents nearly 10% of the world GDP.⁸ Thus, the health of the world economy and more specifically the health of the consumer electronics industry are closely and strongly correlated to the semiconductor demand, which in turn, drives the need for equipment used in production.

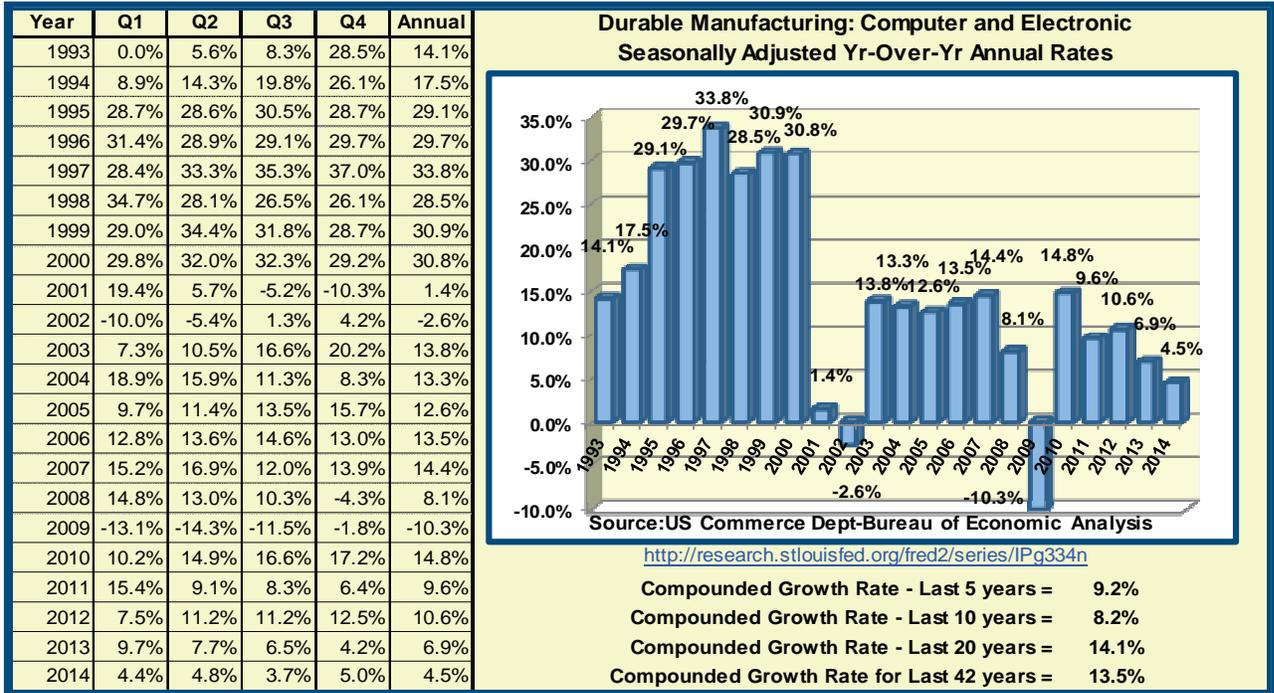
HiTech’s primary downstream market is the computer and electronics industry which enjoyed runaway growth exceeding 25% annually in the 1990’s. From 2001 leading up to the recession, growth still maintained a respectable 9.3% annual rate. The recession in 2009 saw output

⁷ Industry data presented in this section is extracted from “IBISWorld Industry Report-33271, Machine Shop Services in the US,” IBISWorld Inc., January 2015

⁸ WikiInvest, “Semiconductors - Cyclical Drivers,” <http://www.wikinvest.com/industry/Semiconductors>, searched on 10/11/2011, p.2.

decline 10.3%. However, 2010 rebounded by 14.8% and the last five years growth averaged 9.2% annually. As was the case in the fabricated metals sector, growth in 2014 was the slowest during the last five years, averaging just 4.5%.

Exhibit VI Durable Goods - Computer & Electronic



Intel, Advanced Micro Devices (AMD), Samsung, Vishay Intertechnology (VSH), and Maxim are major manufacturers in the computer electronics market. Rapidly changing technologies making pre-existing fabrications obsolete coupled with a declining economy can produce extraordinarily volatile conditions for these companies. As a result, these large players have largely become “fabless” manufacturers. That is, they specialize in the creation, design, assembly, and marketing of the new products and outsource most of the actual manufacturing to smaller independent manufacturers. This gives them the ability to immediately stop production, shutter divisions, or cancel orders with devastating results to those downstream smaller companies that supply them. Those at the bottom of the supply chain, therefore, will experience much greater volatility than the large end-product manufacturers.

The fabricated metal parts manufacturing industry in the U.S. is comprised of about 21,000 companies with combined revenues in excess of \$55 billion. The industry can be characterized as highly fragmented with the top four companies accounting for just two percent of total revenue. Although segments of the industry produce various finished products, the industry largely functions as a supplier of parts and components used in the manufacturing processes of other industrial companies. As such, there is a tendency for specialization which allows small companies to compete effectively. Profitability is frequently driven by the technical expertise and efficiency of those companies filling the niche demands of larger manufacturers. As a result of specialization, it is fairly common for those small companies to have a large

percentage of their output committed to just one or two customers. Such concentration of customers, however, frequently exposes those smaller companies to a highly volatile revenue stream from year to year.

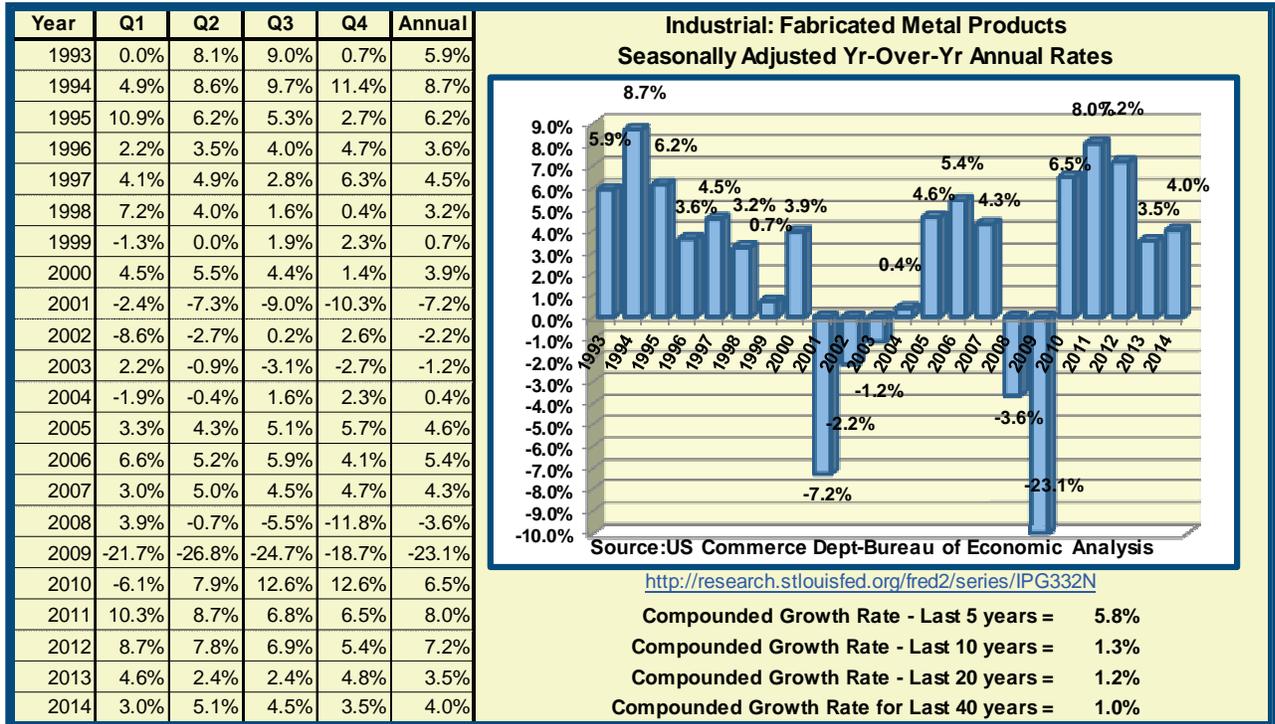
Specialization also drives the need for high levels of engineering skills and a variety of computer-aided manufacturing equipment. Most of the work awarded to fabrication companies is based on their ability to fill the precise production demands of the industrial end user. Consequently the designing and manufacturing capabilities as well as the ability to deliver just-in-time products are often more important than price.

Since the metal fabrication industry predominately acts as a supplier to large manufacturers, its growth is closely tied to that of the manufacturing industry. From the chart below, one can see that growth of the metal fabrication industry tracks that of manufacturers in general as seen in Exhibit V. Total growth of the metal fabrication segment was 4.7% per year from 1993 to 1999. However, since the turn of the century, growth in the manufacturing industry has been very anemic as more and more domestic manufacturing was outsourced to Asia. Imports of fabricated metal products from China rose by nearly 60 percent between 2005 and 2008 which was double the rate of overall import growth. As a result, domestic annual growth from 2001 to 2008 averaged only 0.1% per year. The recession in 2009 saw output plunge by 23.1% to levels not seen since 1993.

During the last five years China's soaring growth rate began to push its inflation rate up to higher levels than here in the United States. In addition, China began to allow its currency to float independently from the U.S. dollar. The combination of events helped reduce the gap between the production costs in China versus the United States. As a result, following 2009, manufacturing in general actually led the economy out of the recession. The fabricated metals sector saw growth jump 6.5% in 2010 and average 5.8% per year for the last five years. Output in 2014 rose 4.0%.

High-tech fabricators are a niche sector of the fabrication industry, providing production support for computer and electronics manufacturers. These fabricators often provide excess production capacity for major manufacturers that must get their products to market quickly in order to beat the competition. In these instances, just-in-time delivery capabilities and high-quality production standards are critical. Many companies in the electronic industry also specialize in product development and marketing and, therefore, must outsource all their manufacturing requirements to smaller fabricators and assemblers. Fabricators in the high-tech sector find that their revenue growth is closely tied to the computer and electronics industry.

Exhibit VII Fabricated Metal Products



The rapidly changing market for metal fabricators means that survival depends on a company’s ability to adapt to new technology, diversify to new industries, and reduce manufacturing costs. Even though the manufacturing industry as a whole is in a malaise, some segments are enjoying strong growth. The defense and aerospace industry, for instance, has largely escaped the effects of the recent recession. In addition, they are frequently required to use only domestic production sources. Thus, those metal fabricators with the ability to meet the high technological demands of the aerospace industry only have to compete with other domestic fabricators where price is a minor issue.

New products that are being introduced in the market today are becoming far more sophisticated in their design which means their parts are more complicated and require tighter manufacturing specifications. High-technology based products generally have a very short life span and competition to get a next generation product to market first is very intense. Thus, these manufacturers depend heavily on the in-house engineering skills of their fabricating suppliers to solve complex manufacturing problems quickly. Consequently growth in the

Machine Shop Industry Data (\$million)					
Year	Revenue	% Gain	Establish-ments	Revenue/Establish (\$mm)	% Gain
2006	42,508		21,356	1.990	
2007	42,036	-1.1%	21,855	1.923	-3.4%
2008	43,508	+ 3.5%	20,964	2.075	+ 7.9%
2009	33,251	-23.6%	19,871	1.673	-19.4%
2010	36,329	+ 9.3%	19,271	1.885	+ 12.7%
2011	41,821	+ 15.1%	19,784	2.114	+ 12.1%
2012	44,896	+ 7.4%	19,952	2.250	+ 6.5%
2013	48,618	+ 8.3%	20,165	2.411	+ 7.1%
2014	52,066	+ 7.1%	20,594	2.528	+ 4.9%
2015	55,190	+ 6.0%	21,051	2.622	+ 3.7%
2016	57,894	+ 4.9%	21,493	2.694	+ 2.7%
2017	59,746	+ 3.2%	21,787	2.742	+ 1.8%
2018	62,077	+ 3.9%	22,155	2.802	+ 2.2%
2019	64,870	+ 4.5%	22,576	2.873	+ 2.6%
2020	66,881	+ 3.1%	22,951	2.914	+ 1.4%
IBISWorld-Report: NAICS 33271					
NAICS Description: Machine Shop Services					

fabricating industry will come to those companies that invest in new technology machinery and in-house engineering support. Computer Assisted Designing (CAD), Computer controlled equipment (CNC), laser cutters that rapidly produce parts directly from CAD files, laser-assisted arc welding, and computer-monitored quality control throughout the entire manufacturing process are all critical elements of success in today's metal fabrication market.

IBISWorld projections for the machine shop services for the next five years are for a 3.9% annual growth rate.⁹

2.4 MARKET DEMOGRAPHICS

The majority of HiTech's customer base is in the San Francisco Bay Area. California was one of the hardest hit states during the recession and the following recovery period, primarily due to the protracted collapse of its housing market and persistent high unemployment. The overall market in which HiTech operates has several bright spots. The Bay Area counties have enjoyed below average unemployment due to the surging high-tech industry. Current unemployment is averaging 4.6% which is well below the state average of 6.8%.

From Exhibit VII¹⁰ below, we can see that the population growth in the State of California averaged 1.3% per year from 1990 to 2000, approximately the U.S. average. The State growth rate, however, slowed somewhat to 1.1% per year from 2000 to 2007, as did the U.S. average. Following the recession, U.S. annual population growth continued to decline from 2007 to 2012 to 0.9% per year. However, California's annual population growth slowed to 0.8% per year.

The five Bay Area counties enjoyed a population growth from 1990 to 2000 that was roughly in line with the state average of 1.2% per year. However, the dot com bust in 2001 precipitated a decline in population from 2002 to 2004. However, by 2007 the region began to grow again, but at a weak 0.4% annual rate. Population growth in the Bay Area counties escalated in 2008 and 2009 as a result of the spike in fuel prices in 2008 and high unemployment in 2009. The

⁹ ,” IBISWorld, Inc. “IBISWorld Industry Report-33271, Machine Shop Services in the US,” IBISWorld Inc., January 2015, p.35

¹⁰ U.S. Census Bureau, American Community Survey-1990-2009, searched December 2011, <http://factfinder2.census.gov/faces/nav/jsf/pages/searchresults.xhtml?refresh=t>

long-term trend toward moving farther east from the Bay Area to take advantage of cheaper home prices was immediately reversed when high gasoline prices forced a great many long-distance commuters to move back. Unemployment in many of the central valley regions to the east of the Bay Area rose above 15% during the recession. The strong high-tech market in the Bay Area had far more employment opportunities than most of the rest of the State of California, thus attracting the unemployed masses. As a result, the region enjoyed above average population growth from 2007 to 2012 compared to the State and the U.S. (1.4% per year vs. 0.8% and 0.9%).

As a result of a surging high-tech market in the Bay Area, growth in Household Income from 1990 to 2000 was significantly higher than the State and the U.S. (4.3% per year vs. 2.9% and 3.4%). The dot com bust in 2001 brought income growth down from 2000 to 2007 with the region averaging just 2.5% growth per year compared to 3.4% for the State and 2.7% for the U.S. However, from 2007 to 2012 the persistently high unemployment rate that plagued California largely bypassed the Bay Area. As of year-end 2014 the region is averaging approximately 4.5% unemployment compared to 6.7% for the State of California. As a result, Household Income in the Bay Area did not suffer the same fate as the rest of the state. Household Income in the Bay Area counties increased 1.5% per year from 2007 to 2012, whereas the state declined -0.5% per year and the nation as a whole declined at a 0.1% annual rate.

The depressed housing market has also acted as a significant drag on the local and California economies and, to a lesser extent, the whole nation. In the early 2000's rapidly-increasing housing prices added billions of dollars to homeowner equity which was borrowed against to purchase cars, boats, more property, etc. The ensuing decline in housing values wiped out much of homeowner equity, thus ending the spending spree. From 2000 to 2007 housing prices increased a total of 151.7% in California compared to 62.5% for the nation as a whole and 99.6% for the Bay Area counties. From 2007 to 2014 the collapse in housing prices affected those areas the worst where price increases were the most during the preceding seven years. Thus from 2007 to 2014 the housing prices for the nation as a whole declined 10.5% compared to a 16.2% decline for the Bay Area and 34.4% for the whole state. From 2010 to 2014 housing prices have increased modestly in the Bay Area, thus restoring most of the losses incurred since 2007. As such, the housing bubble that brought the rest of California to its knees did not affect the Bay Area nearly as badly.

The effects of population growth and income growth on the value of a business will be discussed further in Section 7.4.2 below.

Exhibit VIII Demographics

		U.S.	California	Santa Clara County	Contra Costa County	San Francisco County	San Mateo County	Alameda County		
Population	1990	248,710,000	29,760,000	1,497,000	803,700	724,000	650,000	1,279,000	5 Regions Wgt Avg By Population	
	2000	281,421,000	33,871,648	1,686,000	948,800	777,000	708,000	1,444,000		
	2007	301,621,000	36,553,215	1,749,000	1,019,600	765,000	707,000	1,464,200		
	2013	316,128,839	38,041,430	1,862,000	1,094,200	837,400	747,400	1,578,900		
	Gain '07 to '13	0.9% per year	0.8% per year	1.3% per year	1.4% per year	1.8% per year	1.1% per year	1.5% per year		1.4% per year
	Gain '00 to '07	1.0% per year	1.1% per year	0.5% per year	1.0% per year	-0.2% per year	0.0% per year	0.2% per year		0.4% per year
	Gain '90 to '00	1.2% per year	1.3% per year	1.2% per year	1.7% per year	0.7% per year	0.9% per year	1.2% per year		1.2% per year
Median Household Income	1990	\$30,000	\$35,798	\$48,100	\$45,100	\$33,400	\$46,400	\$37,500	\$42,505	
	2000	\$41,994	\$47,493	\$74,300	\$63,700	\$55,200	\$70,800	\$56,000	\$64,630	
	2007	\$50,700	\$59,948	\$84,400	\$76,400	\$68,000	\$83,100	\$68,740	\$76,591	
	2013	\$52,250	\$58,328	\$92,000	\$79,100	\$77,500	\$91,300	\$72,400	\$82,567	
	Gain '07 to '13	0.6% per year	-0.5% per year	1.7% per year	0.7% per year	2.6% per year	1.9% per year	1.0% per year	1.5% per year	
	Gain '00 to '07	2.7% per year	3.4% per year	1.8% per year	2.6% per year	3.0% per year	2.3% per year	3.0% per year	2.5% per year	
	Gain '90 to '00	3.4% per year	2.9% per year	4.4% per year	3.5% per year	5.2% per year	4.3% per year	4.1% per year	4.3% per year	
Median Housing Prices	1990	\$78,500	\$195,500	\$287,700	\$217,100	\$294,800	\$340,800	\$225,300	\$268,140	
	2000	\$119,600	\$211,500	\$446,000	\$268,000	\$396,000	\$469,000	\$301,100	\$373,983	
	2007	\$194,300	\$532,300	\$758,100	\$622,200	\$830,700	\$843,100	\$651,800	\$726,798	
	2013	\$173,900	\$349,400	\$682,300	\$424,100	\$778,000	\$748,300	\$518,900	\$615,134	
	Gain '07 to '13	-10.5%	-34.4%	-10.0%	-31.8%	-6.3%	-11.2%	-20.4%	-16.2%	
	Gain '00 to '07	62.5%	151.7%	70.0%	132.2%	109.8%	79.8%	116.5%	99.6%	
	Gain '90 to '00	52.4%	8.2%	55.0%	23.4%	34.3%	37.6%	33.6%	39.0%	
Unemployment	Dec-2009	9.9%	11.8%	10.8%	10.6%	8.9%	8.4%	10.4%	10.1%	
	Dec-2014	5.6%	6.8%	4.5%	5.2%	3.9%	3.6%	5.1%	4.6%	
	Change	-4.3%	-5.0%	-6.3%	-5.4%	-5.0%	-4.8%	-5.3%	-5.5%	

Source: U.S. Census - <http://factfinder2.census.gov/> U.S. Bureau of Labor Statistics - <http://data.bls.gov>

2.5 IMPLICATIONS FOR THE SUBJECT

HiTech is a contract manufacturer and, as such, is reliant on its downstream business partners for its source of revenue. Nearly 90% of HiTech's production consists of components and sub-assemblies ultimately used by Google to manufacture finished products for its own use or for products it sells to other businesses or consumers. Since Google is a high-tech company immersed in the computer and electronics industry, HiTech is essentially a supplier to that industry as well. Thus, even though it is part of the slow-growth metal fabrication industry, HiTech's main customer is part of the high-growth computer and electronics industry. Over the last 40 years the metal fabrication industry has been mired in stagnant growth averaging 1.0% per year. However, during that period, the computer and electronics industry has enjoyed a stellar 13.5% annual growth rate. Even though growth in the electronics industry has slowed considerably since the start of the century, the industry is still averaging over 8% per year.

The recession year of 2009, however, saw the computer and electronics industry revenues decline by 10.3%, its worst year on record. As was noted in the industry section, the metal fabricating shops are often called upon to fill in when primary manufacturers are scrambling to meet burgeoning demand and need additional capacity. As a result, when the economy slows down, the fab shops are generally the first suppliers to get cut back. This situation was clearly demonstrated in 2009 when metal fabricating industry revenues dropped 23.1%. HiTech's experience was no different. Its revenues in 2009 dropped over 40%. The economic

rebound from the depths of the recession was quick and significant. In 2010 the fabricated metal industry revenues jumped 6.5%, the computer and electronics industry jumped 14.8%, and HiTech jumped 88%.

HiTech also benefits from the strong economy in the San Francisco Bay Area. Even though Google is an international entity, its home base is the Bay Area. Since the recession, the Bay Area has enjoyed above-average population and household income growth. Unemployment has also been well below state and national levels.

Analysis: LONG-TERM PROJECTED GROWTH

HiTech's post-recession annual growth rate averaged 1.3% from 2010 to 2014, which was substantially higher than the peer group's 1.2% decline. When including the recession year of 2009 as the base year, growth averaged 14.6% annually for HiTech and 0.5% for the peer group. The industry as a whole has only grown at a 1.3% annual rate for the last ten years primarily due to adverse trade conditions with China. However, the last five years has seen improvements in trade with China which has resulted in the fabricated metal industry growing at a 5.8% annual rate. As the industry continues rebounding over the next five years, we would expect HiTech to continue rebounding as well. The local demographics for HiTech's market show an above-average household income growth which supports a long-term above-average growth rate for the company. Current local unemployment rates have declined to levels that are lower than the average over the last ten and 20 year periods. Annual GDP growth over the last 50 years was 6.5%; however, for the last 20 years it has leveled out at 4.4%.

IBISworld's five-year projection for the fabricated metal manufacturing industry is for a 3.9% annual growth rate. Although the growth rate is occurring at a slower pace than the projected GDP growth and slower than the 5.8% annual growth enjoyed by the industry over the last five years, it is considerably better than the 1.2% rate observed over the last 20 years. We would expect HiTech's long-term revenue and earnings growth to be moderately higher than projected industry growth because of its concentration in the computer and electronics sector. However, we must still temper our projection with the knowledge that periodic recessions will undoubtedly produce devastating declines in revenue as it has in the past.

Nominal Growth Rates by Sector	Last 50 years	Last 20 Years	Last 10 Years	Last 5 Years
GDP	6.5%	4.4%	3.6%	3.9%
Personal Consumption	6.8%	4.7%	3.7%	3.9%
Corporate Profits	7.8%	7.8%	6.8%	8.7%
Durable Manufacturing	3.4%	4.0%	2.5%	7.0%
Fabricated Metal Manufacturing	1.0%	1.2%	1.3%	5.8%
Computers & Electronics Mfg.	13.5%	14.1%	8.2%	9.2%

Thus, we will select a 5.0% long-term growth rate in our capitalization rate calculations in the Income Approach.

3.0 COMPANY HISTORY AND ORGANIZATION

3.1 COMPANY HISTORY

HiTech Precision Sheetmetal, Inc. is presently located at 1015 Anystreet Road, Silicon Valley, California, the center of San Francisco Bay Area. The company was founded in 1999 in what is a recurring theme in Silicon Valley: the startup began in the owners' garage. John and Jane Smith, who operated the business from the start, soon moved it to a small warehouse in Sunnyvale several miles to the north of its present location. In 2001 HiTech acquired a relationship with Google which quickly absorbed most of its available capacity. By 2006 the company outgrew its Sunnyvale plant and relocated to Anystreet Road in Silicon Valley. The new location is a 58,000 sq. ft. office/warehouse on 2.57 acres of land.

HiTech is a full-service contract manufacturer of metal formed products. It is typically involved in the production process from prototype to mass production. Its output is usually components and subassemblies that are used in the manufacturing process of its downstream customers. These products find their way into various industries such electronics, aerospace, medical, automotive, and telecommunications. Most of what HiTech produces is heavy and bulky and requires regular interaction between HiTech's and the customer's engineers to enable a quick turnaround. As such, potential competition from Asian manufacturers is mitigated.

In many cases HiTech's in-house engineering staff works with its customers by assisting in the initial designing of a product. Usually the customer provides a model of the component to be produced. Once the design is finalized and the engineering is set up in HiTech's computers, a prototype or working model is produced that is submitted to the customer for final approval. HiTech is set up with ERP software that enables HiTech to communicate directly with its customers' computers from the design stage to invoicing. HiTech is able to work with the customer with inventory control programs such as Kanban, or "just-in-time" shipments. Since most of the company's machines are computer controlled, set up time for each production run is reduced. Thus, HiTech can economically produce smaller lots that are shipped as needed by the customer over the course of several months. The ability to quickly manufacturer small runs eliminates the need to produce overruns to cover the prospects that a customer discovers it needs a few more items. Consequently HiTech generates a minimal amount of waste or unusable inventory.

3.1.1 CUSTOMER CONCENTRATION

Over the last few years HiTech's relationship with Google has resulted in it focusing on the manufacture of computer networking chassis and server mainframes that often are fully equipped with built-in electronic components. Google has been rapidly expanding its network of data centers around the world and HiTech has been instrumental in supplying the chassis in which the computers and telecommunication equipment are installed.

HiTech's Top five customers and the percentage of HiTech's sales for the last two years are:

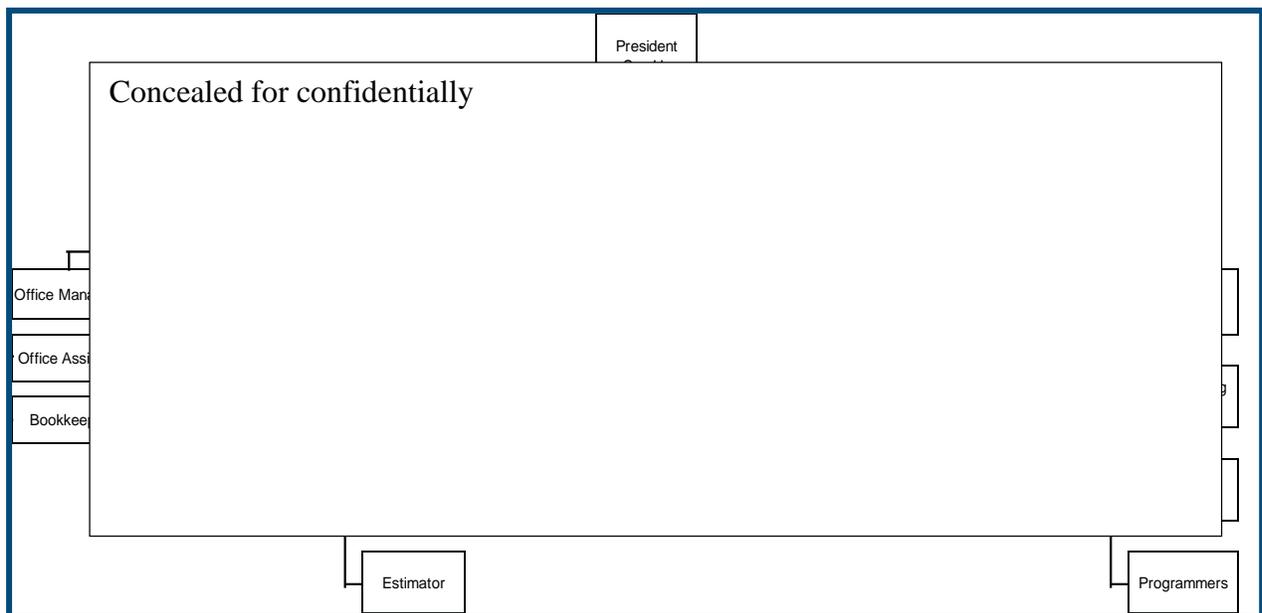
	<u>2013</u>	<u>2014</u>	<u>Start of Relationship</u>
Google	59%	59%	2001
Mobile Materials	25%	29%	2004
AMX Solutions	2%	0.7%	2008
Autoimage	2%	3%	2012
United Corp	2%	0.4%	2010

Mobile Materials is a fabrication shop which installs HiTech’s products in components it manufactures for Google. Consequently Google ultimately accounts for approximately 85% to 90% of HiTech’s output.

Mr. Smith indicated that sales to Google have been fairly consistent over the last five years. The company’s relationship with Google remains strong and prospects for future business is good. Google has given HiTech a rating of 4.38 out of five based on pricing, service, and performance which is considered a top rating. HiTech works under a contract with Google that typically locks in its labor and material costs. HiTech submits a bid prior to each job. Even though the bids are open to competition, Mr. Smith indicates that HiTech is usually awarded the order. The contracts with Google are for a fixed price; however, they usually allow unforeseen material cost increases to be passed on to Google.

HiTech does not run production on the weekends. At present, it often runs more than one shift per day as demand calls for it. The company has the ability to run three shifts a day if needed. Hence, it is effectively presently running at 40% to 60% capacity. Contract orders typically average \$50,000 each which can be completed within four weeks. The company has the capability of running up to 100 top-level assembly jobs at a time, which translates into a potential 1,000 individual work orders. HiTech’s extensive computerization of its equipment enables it to produce orders in a very quick turnaround time, one of its major selling points.

3.1.2 MANAGEMENT ORGANIZATION



The company presently has 133 employees with approximately 100 involved in the production side of the business and the remaining 33 working in various office capacities. The management team includes three executive-level managers, including Son and Jane Smith. There are seven senior manager positions controlling 16 mid and lower-level managers.

Bill Johnson, General Manager, is salaried at \$150,000 per year. He has been with the company for 13 years. He is responsible for contributing to the overall strategic planning and direction of the company and staff as well as the day-to-day management decision making.

John Jones, Client Services and Engineering Manager, is salaried at \$108,160 per year. He has been with the company for 15 years. His duties include acting as the primary business contact for clients and to strategically build, manage, and monitor key relationships with their accounts. He also monitors the engineering team of the firm.

Jim Crane, Production Floor Manager, is salaried at \$72,800 per year. He has worked for the company for eight years. His duties include managing all floor supervisors and production flows.

Ken Smith, Quality Control Manager, is salaried at \$75,000 per year. He has worked for the company for three years. He plans, coordinates, and directs the quality program and processes throughout the company to ensure all established quality standards are maintained.

Kenny Loggins, NC/Laser Supervisor, is salaried at \$72,160 per year. He has worked for the company for four years. He is responsible for supervising, and managing the NC and Laser Department and oversees the processes and procedures implemented there.

Larry Hall, Brake and Hardware Supervisor, is salaried at \$68,320 per year. He has worked for the company for six years. He is responsible for running the press brake department.

Sam Sung, ASM/Inventory/Shipping Receiving Supervisor, is salaried at \$67,300. He has worked for the company for three years. He manages the electro-mechanical assembly Department. He also supervises the workers engaged in preparing items for shipment and maintaining the records on incoming and outgoing freight.

Richard Lian, Facility Manager, is salaried at \$60,769. He has worked for the company for nine years. He is responsible for overall repairs and upkeep of building and grounds. Oversees daily maintenance and janitorial operations.

Specific details on the Subject's operations are discussed in the notes to the P&Ls and balance sheet following page 107.

4.0 ANALYSIS OF THE COMPANY

4.1 FINANCIAL STATEMENTS

Tax returns are the primary source of information used in the analysis. Mr. Smith supplied tax returns for years ending 2010 through 2013. P&Ls for years ending 2010 through 2014 were also supplied. The most recent Balance Sheet is as of December 31, 2014. The P&Ls are internal documents that may or may not have been reviewed or adjusted by a CPA. No opinion as to the accuracy of the financials is offered by the Appraiser. John Smith, the owner, was interviewed by the Appraiser on March 31, 2015. The Owner's Discretionary Cash Flow Analysis was based on statements made in that interview.

Detailed information on the adjustments that were made to these P&Ls can be found on Exhibit XLII, Page 103.)

4.1.1 ANALYSIS OF HISTORICAL INCOME STATEMENTS

HiTech has seen moderate growth in revenues during the last six accounting periods. However, sales declined 6.3% in the current year. Net income, however, has been moderately volatile from year to year. The bar charts below give a visual presentation of its recent history.

Exhibit IX Revenue and Taxable Income

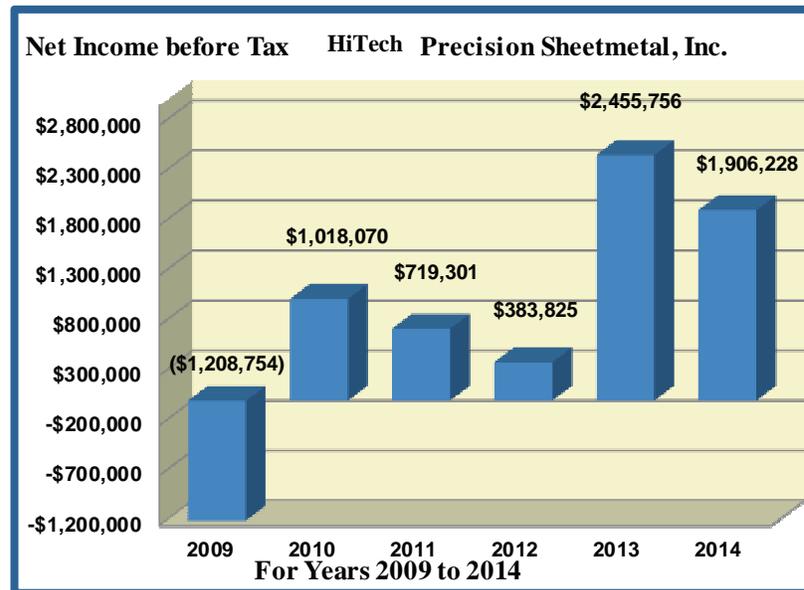
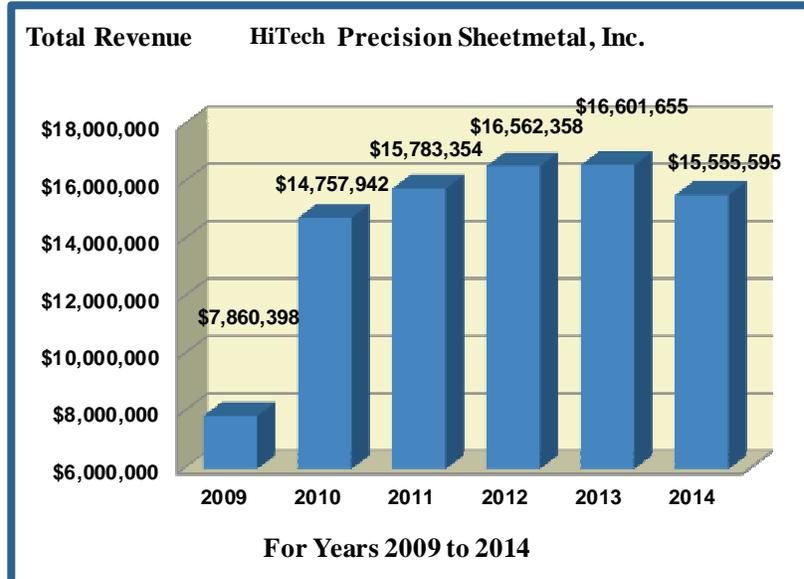


Exhibit X Income Statement - 2010 to 2014

	Dec 31, 2014	Dec 31, 2013	Dec 31, 2012	Dec 31, 2011	Dec 31, 2010
	12 Mos.				
INCOME					
Sales	15,501,810	16,599,389	16,557,166	15,783,354	14,757,942
Freight, Design	53,785	2,266	5,192	-	-
TOTAL INCOME	15,555,595	16,601,655	16,562,358	15,783,354	14,757,942
COST OF GOODS SOLD					
Net Purchases	3,870,616	5,590,721	7,115,630	6,449,277	6,649,170
Direct Mfg. Labor	2,508,059	2,057,322	2,008,741	2,471,732	1,852,822
Direct Subcontract Labor	352,264	195,743	190,390	68,159	89,831
Direct Overhead	60,292	59,180	65,175	88,628	66,958
Indirect Labor	1,984,346	1,087,536	1,013,935	773,442	712,620
Shop Supplies	293,598	244,935	256,004	394,923	188,842
TOTAL COST OF GOODS SOLD	9,069,175	9,235,437	10,649,875	10,246,161	9,560,243
GROSS PROFIT	6,486,420	7,366,218	5,912,483	5,537,193	5,197,699
	41.7%	44.4%	35.7%	35.1%	35.2%
OTHER INCOME					
Expedite Charge	34,274	9,924	1,038	500	-
NR Charge	12,152	3,979	22,144	7,155	-
Other Income	11,592	54,344	33,470	23,202	9,239
Gain (Loss) Sale of Assets	14,685	91,996	76,500	(54,105)	-
Purchase Discounts, Interest	23,704	11,464	1	28	2,077
TOTAL OTHER INCOME	96,407	171,707	133,153	(23,220)	11,316
EXPENSES					
Compensation to Owner	722,956	528,846	503,269	443,250	528,846
Payroll Expense	294,457	1,088,278	1,129,473	1,079,280	697,333
Commission Expense	3,085	20,002	10,319	17,514	20,741
Accrued Vacation	(176,286)	25,276	77,034	38,809	13,037
Repairs and Maintenance	137,551	89,642	91,121	65,326	178,233
Bad Debts	3,239	-	525	22,779	-
Rent	654,300	439,555	796,802	696,634	590,779
Executive Expenses	-	-	-	11,702	19,978
Payroll Taxes	455,685	396,805	380,695	418,077	320,645
Pension Contribution 401K	12,889	12,270	10,116	7,045	6,008
Advertising	2,576	2,404	2,810	3,208	3,992
Donations, Gifts, Awards	3,400	9,075	4,665	9,863	150
Sales Tax	26,658	22,245	18,400	38,263	21,616
State Income Taxes	800	800	800	1,600	800
Taxes, Licenses and Permits	6,925	5,544	5,409	3,892	4,143
Depreciation, Amortization	344,149	421,807	540,400	401,423	397,756
Property Taxes	28,901	31,177	50,224	25,198	27,674
Interest Expense, Penalties	43,527	53,277	94,724	52,008	49,960
Outside Services	1,979	4,930	-	-	-
Auto Expense	90,228	36,275	33,553	42,172	33,879
Bank and Credit Card Charges	4,312	4,183	3,935	8,027	8,634
Insurance	23,385	28,076	21,337	44,732	21,679
Health Insurance	341,479	380,645	362,845	289,954	242,566
Workman's Comp	249,237	207,265	215,569	230,755	149,430
Professional Services	528,706	594,474	475,103	184,376	233,051
Office Expense, Printing	83,346	47,430	28,341	30,305	35,361
Sm Computer Equipment	23,640	29,843	15,366	14,449	10,285
Misc., Dues, Training	22,778	8,614	9,362	5,491	6,380
Operating Expense	19,978	11,870	15,080	16,543	15,230
Company Event	16,491	22,673	-	1,272	-
Travel and Entertainment	46,180	24,127	23,881	14,126	15,727
Employee Meals	21,235	10,229	12,508	11,388	11,248
Supplies	52,695	50,121	37,095	51,006	26,069
Freight & Shipping, Postage	348,971	244,919	463,063	304,224	337,558
Expedite Fee (Moving Expense)	3,525	2,667	6,189	11,731	1,307
Small Tool Expense	-	7,099	9,962	3,208	1,476
Utilities	233,622	219,726	211,836	195,042	159,374
TOTAL EXPENSES	4,676,599	5,082,169	5,661,811	4,794,672	4,190,945
Net Income Per Tax Return/P&Ls	1,906,228	2,455,756	383,825	719,301	1,018,070

Income statements for HiTech for the last five accounting periods are as follows:

(Detailed information on P&Ls can be found on Exhibit XLII, Page 103)

4.1.2 COMMON SIZED INCOME STATEMENT

For comparison purposes, each income statement entry above is recalculated and expressed in terms of its percentage of total revenues. This format, referred to as a “common-size” presentation, makes it easier to compare the Subject Company to its industry peers. Industry comparison data is shown to the left of the Subject’s data. The industry data was taken from Bizminer¹¹ under SIC code #3444, Fabricated metal products - Sheet Metal Work. There were 6,999 companies whose revenues ranged from \$10 million to \$24.99 million that were in the sub-category, Sheet Metal Fabrication.

Exhibit XI Common Size Income Statement - 2010 to 2014

HiTech Precision Sheetmetal, Inc.										
COMMON SIZED INCOME STATEMENT	2014		2013		2012		2011		2010	
	Industry	Subject								
Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Goods Sold	72.7%	58.3%	72.7%	55.6%	70.8%	64.3%	73.2%	64.9%	74.0%	64.8%
Gross Margin	27.3%	41.7%	27.3%	44.4%	29.2%	35.7%	26.8%	35.1%	26.0%	35.2%
Other Income	0.8%	0.6%	0.8%	1.0%	0.5%	0.8%	1.1%	-0.1%	0.7%	0.1%
Expenses										
o Officer/Manager Salaries	2.8%		2.9%	3.2%	4.5%	3.0%	2.8%	2.8%	3.0%	3.6%
s Salary and Wages	5.2%	5.4%	5.3%	6.8%	5.9%	7.3%	4.9%	7.2%	4.8%	5.0%
r Rent	2.0%	4.2%	2.1%	2.6%	1.6%	4.8%	1.4%	4.4%	1.2%	4.0%
tl Taxes, Payroll Taxes	2.1%	3.3%	2.1%	2.7%	2.0%	2.7%	1.9%	3.1%	1.5%	2.5%
a Advertising	0.6%	0.0%	0.6%	0.0%	0.3%	0.0%	0.4%	0.0%	0.3%	0.0%
b Benefits/ Pension	2.0%	0.1%	2.0%	0.1%	1.7%	0.1%	2.1%	0.1%	1.6%	0.1%
rm Repairs & Maintenance	0.7%	0.9%	0.7%	0.5%	0.6%	0.6%	0.4%	0.4%	0.5%	1.2%
bd Bad Debts	0.2%	0.0%	0.2%	0.0%	0.1%	0.0%	0.2%	0.1%	0.2%	0.0%
oe Other Expenses	4.0%	13.6%	4.0%	11.7%	3.6%	11.7%	4.4%	9.3%	4.4%	8.9%
i Interest	0.4%	0.3%	0.4%	0.3%	0.5%	0.6%	0.3%	0.3%	0.4%	0.3%
d Depreciation	2.6%	2.2%	2.6%	2.5%	2.5%	3.3%	1.8%	2.5%	2.4%	2.7%
Net Income Before Tax	5.4%	12.3%	5.2%	14.8%	6.4%	2.3%	7.2%	4.6%	6.4%	6.9%
it Income Taxes	1.8%	0.0%	1.8%	0.0%	2.2%	0.0%	2.4%	0.0%	2.2%	0.0%
Net Income After Tax	3.6%	12.3%	3.5%	14.8%	4.2%	2.3%	4.7%	4.6%	4.2%	6.9%
EBITDA + Officer Compensator	11.3%	14.8%	11.2%	20.8%	13.8%	9.2%	12.1%	10.2%	12.2%	13.5%

4.1.2.1 REVENUES

Revenue of the Bizminer companies representing the peer group increased by a 0.5% compounded annual growth rate (CAGR) from 2009 to 2014. The best year was 2010 with a gain of 7.9% over the prior year and, 2014, the worst year, showed a decline of 7.5%. EBITDA for the peer group declined by 1.1% CAGR from 2009 to 2014. The best year was 2010 with a gain of 11.1% over the prior year and, 2013, the worst year, showed a decline of 13.5%.

¹¹ Bizminer, 5 year report - SIC Code #3444, searched at www.bizminer.com on March 31, 2015

Growth from 2009 to 2014	2010	2011	2012	2013	2014	CAGR
Industry - Revenue	7.9%	1.4%	-0.7%	2.1%	-7.5%	0.5%
Industry - EBITDA	11.1%	-1.3%	6.3%	-13.5%	-6.0%	-1.1%
Subject - Revenue	87.8%	6.9%	4.9%	0.2%	-6.3%	14.6%
Subject - EBITDA	Neg.	-20.0%	-13.1%	187.6%	-21.7%	9.4%

The available comparable data for the Subject spanned from 2009 to 2014. During this period the Subject's revenue increased at an annual rate of 14.6% which was superior to the peer group's 0.5% increase. However, most of the Subject's gain during the five-year period occurred in 2010 as it rebounded from recession-depressed 2009. Its annual growth over the last four years averaged a lackluster 1.3%. Its EBITDA increased at an annual rate of 9.4% which was superior to the peer group's 1.1% decline. The Subject's revenues for 2014 declined 6.3% over 2013 which was superior to the peer group's 7.5% decline. Its normalized EBITDA for 2014 showed a loss of 21.7% over 2013 compared to the industry's 6% decline.

4.1.2.2 RENT

Rent is always a potential risk factor for a small business. High-level rent can drain away needed cash flow for growth, capital expenditures, and working capital. The industry rent for the last five accounting periods has averaged 1.7% of Revenues. HiTech averaged 4.0% of its revenues in rent. HiTech's present level of rent is 4.2% of revenues compared to the industry's 2.0%. The real estate from which the company operates is owned by an LLC of which Mr. Smith is the sole owner. Special circumstances arise in the valuation of a business when the owner of a business also owns the real estate occupied by that business. (See a complete discussion under cell F43, Page 110). Mr. Smith estimated fair market value of the real estate was \$5,000,000, which if acquired by a buyer of the business, would carry debt service of \$345,215 per year. This hypothetical cost of the property is only 2.2% of the company's current level of revenue which is in line with the peer group's rent level. Thus, hypothetical rent does not pose any increased risk to the Subject's future cash flow.

4.1.2.3 GROSS PROFITS AND PAYROLL

The industry payroll expense as a percentage of revenues for the last five accounting periods has averaged 5.2%, whereas the Subject's averaged 5.4%. However, some of the Bizminer companies include a portion of labor in Cost of Goods Sold and some do not. Thus, a more

HiTech	2014	2013	2012	2011	2010
Gross Margin	41.7%	44.4%	35.7%	35.1%	35.2%
Labor Costs	0.8%	6.8%	7.3%	7.2%	5.0%
Net Margin after Labor	40.9%	37.6%	28.4%	27.9%	30.2%
Industry	2014	2013	2012	2011	2010
Gross Margin	27.3%	27.3%	29.2%	26.8%	26.0%
Labor Costs	5.2%	5.3%	5.9%	4.9%	4.8%
Net Margin after Labor	22.1%	22.0%	23.3%	21.9%	21.2%

accurate view of this expense would be to look at gross profits after all labor expenses regardless of whether labor was expensed or included in Cost of Goods Sold.

HiTech's Net Margin after Labor averaged 33.0% of revenues from 2010 to 2014, whereas the industry averaged 22.1%. However, the gap widened significantly by 2014 with the Subject earning 40.9% compared to the industry's 22.1% rate.

The Company's average Net Margin after Labor is moderately higher than the peer group. Thus, the company's ability to generate cash flow will have a significantly positive impact on the growth potential of the company.

4.1.2.4 EBITDA + OWNER'S COMPENSATION

HiTech's overall cash flow as a percentage of gross revenues (as measured by EBITDA plus Owner's salary) averaged 13.7% from 2010 to 2014 whereas, the industry averaged 12.1% over the same five accounting periods. In other words, for every \$1,000 increase in revenues, HiTech puts \$137 on the bottom line whereas, the industry puts \$121. The Subject's cash flow margin has generally improved over the last four years; whereas, the industry has declined. During the most current year, HiTech's cash flow margin declined to 14.8% of revenues whereas, the industry was nearly the same at 11.3%. Thus, on an overall cash flow basis the Subject has a moderate advantage over the industry.

Analysis: The subject's high net-profit-margin-after-labor has more than offset its high rent and other operating costs. The company's production process appears to be very efficient affording it much higher profit margins than its peer group. As we will see in the balance sheet analysis, the subject carries a moderately higher level of fabricating machines that are high-tech which reduces the labor component of its cost of goods sold.

4.2 SUMMARY OF HISTORICAL BALANCE SHEETS

The balance sheets for HiTech for the last five accounting periods are as follows:

Exhibit XII Balance Sheet - 2010 to 2014

HiTech Precision Sheet Metal	Dec 31, 2014	Dec 31, 2013	Dec 31, 2012	Dec 31, 2011	Dec 31, 2010
Cash and Equivalent	814,074	2,770,420	416,513	877,929	95,942
Accounts Receivable	2,045,025	1,403,313	2,772,009	3,016,264	2,843,715
Inventory-Raw Materials	465,671	291,038	697,447	554,419	870,996
Inventory-Work in Process	80,138	85,764	476,041	606,118	255,555
Inventory-Finished Goods	179,992	53,960	108,781	209,785	180,050
Employee Receivables	80,975	88,112	79,947	25,800	
Due From Shareholder	100,000				
Prepays, Deposits	85,048	77,988	58,864	47,533	28,091
Total Current Assets	3,850,923	4,770,595	4,609,602	5,337,848	4,274,349
Fixtures & Equipment	4,678,941	5,020,071	5,043,578	5,065,839	4,304,153
Depreciation	(3,070,053)	(3,011,954)	(2,787,891)	(2,344,545)	(2,049,017)
Tenant Improvements	409,017				
TI-Depreciation	(269,404)				
Lease Deposits			17,371	14,971	
Total Assets	<u>5,599,424</u>	<u>6,778,712</u>	<u>6,882,660</u>	<u>8,074,113</u>	<u>6,529,485</u>
Accruals	294,495	270,164	302,481	194,893	208,117
Rent Payable					577,352
Credit Cards	20,333	8,557			
Accounts Payable	682,537	207,039	922,278	1,813,741	993,834
Notes, Lines of Credit	375,000		60,000	395,612	798,375
Total Current Liabilities	1,372,365	485,760	1,284,759	2,404,246	2,577,678
Long-Term Debt	629,340	970,651	1,718,751	2,208,997	688,556
Deferred Taxes	10,000	10,000	10,000	10,000	10,000
Due to Shareholder	984,208	984,207	1,459,688	1,015,405	1,230,119
Total Liabilities	2,995,913	2,450,618	4,473,198	5,638,648	4,506,353
Net Worth	2,603,511	4,328,094	2,409,462	2,435,465	2,600,484
Total Liabilities + Net Worth	<u>5,599,424</u>	<u>6,778,712</u>	<u>6,882,660</u>	<u>8,074,113</u>	<u>7,106,837</u>

(Detailed information on the adjustments that were made to the Balance Sheets can be found on Exhibit XLII, Page 103.)

4.2.1 COMMON SIZED BALANCE SHEET

For comparison purposes, each balance sheet entry above is recalculated and expressed in terms of its percentage of total revenues. This format, referred to as a “common-size” presentation, makes it easier to compare the Subject Company to its industry peers. Industry comparison data is shown to the left of the Subject’s data. The industry data was taken from Bizminer under SIC code #34, Fabricated metal products. There were a total of 6,999

companies in the database whose revenues ranged from \$10 million to \$24.99 million that were in the sub-category, Sheet Metal Fabrication.

Analysis of the common size balance sheet will be incorporated in the ratio analysis below:

Exhibit XIII Common Size Balance Sheet - 2010 to 2014

COMMON SIZED BALANCE SHEET	HiTech Precision Sheetmetal, Inc.									
	2014		2013		2012		2011		2010	
	Industry	Subject	Industry	Subject	Industry	Subject	Industry	Subject	Industry	Subject
Assets										
c Cash/Securities	14.7%	14.5%	14.7%	40.9%	14.8%	6.1%	15.1%	10.9%	14.0%	1.5%
ar Accounts Receivable	30.8%	36.5%	30.8%	20.7%	29.6%	40.3%	30.2%	37.4%	31.3%	43.6%
in Inventory/WIP	18.0%	13.0%	18.0%	6.4%	19.0%	18.6%	17.8%	17.0%	15.8%	20.0%
ca Other Curr Assets	2.0%	4.8%	2.0%	2.5%	2.5%	2.0%	1.5%	0.9%	2.7%	0.4%
Total Current Assets	65.6%	68.8%	65.4%	70.4%	65.9%	67.0%	64.6%	66.1%	63.7%	65.5%
f Prop, Plant, Equip - NET	19.8%	31.2%	19.9%	29.6%	20.6%	32.8%	17.4%	33.7%	21.2%	34.5%
oa Other Assets	14.6%	0.0%	14.7%	0.0%	13.4%	0.3%	17.9%	0.2%	15.0%	0.0%
Total Assets	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Liabilities										
ap Accounts Payables	14.4%	12.2%	14.5%	3.1%	12.1%	13.4%	14.6%	22.5%	12.8%	15.2%
sd Short Term IB Debt	4.6%	6.7%	4.7%	0.0%	3.9%	0.9%	2.4%	4.9%	3.0%	12.2%
cl Other Current Liabilities	9.5%	5.6%	9.9%	4.1%	10.1%	4.4%	11.2%	2.4%	11.0%	12.0%
Total Current Liabilities	28.5%	24.5%	29.2%	7.2%	26.1%	18.7%	28.2%	29.8%	26.8%	39.5%
ol Other Liabilities		17.8%		14.7%		21.4%		12.7%		19.0%
ld Long Term IB Debt	11.3%	11.2%	11.7%	14.3%	11.8%	25.0%	11.2%	27.4%	14.4%	10.5%
Total Liabilities	39.8%	53.5%	40.9%	36.2%	37.9%	65.0%	39.4%	69.8%	41.1%	69.0%
Total Net Worth	60.2%	46.5%	59.1%	63.8%	62.1%	35.0%	60.6%	30.2%	58.9%	39.8%
Total Liab & Net Worth	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	108.8%

4.3 INDUSTRY RATIOS

The Bizminer data provides industry comparisons of key financial ratios. These ratios tie the income statement data to the balance sheet data and provide us with a means to critically analyze the strengths and weaknesses of a company's operations compared to its peers. The industry data was taken from Bizminer¹² under SIC codes #34, Sheet Metal Fabrication. The financial data for each of these SIC classifications was averaged together to obtain a composite profile that more accurately reflects the various characteristics of HiTech. There were 6,999 companies in these groups with sales ranging from \$10 million to \$24.99 million.

Ratio analysis allows us to look at a company's balance sheet to determine if its assets and liabilities are adequate to support the level of revenues that the company is generating. If a company has an insufficient level of critical assets to support its revenue stream, we must assume that the current level of revenue or profits may be in jeopardy. For example, if on the average, a particular industry can produce \$3 in sales for every \$1 invested in inventory, then a company that produces \$5 in sales for \$1 in inventory may be trying to "work its inventory too hard." A low inventory investment with respect to a given sales level may cause the company to frequently be out of stock of key items or, it may mean the company places frequent small orders because it cannot afford to buy large orders over longer time intervals.

¹² Bizminer, 5 year report - SIC Codes #34 searched at www.bizminer.com, on March 31, 2015.

Essentially we are looking at a company that is in danger of losing customers because of recurring out-of-stock situations or it is incurring higher labor, freight, and material costs due to frequent restocking of uneconomical order size.

Ratio analysis can also be useful in determining if a company has surplus assets that are not essential to the income-producing operations of the business. It is common to find companies that carry more cash than is needed to run the business. Owners of C-Corporations, for example, often leave excess cash in the company because removing it would trigger a dividend tax to the recipient. A surplus cash balance is considered a “non-operating asset” (i.e. not essential to the continued profitable operations of the Company). Other assets may also be considered non-operating in nature; that is, they are not essential to the profit generating operations of the Company. In a later section of this report we will construct a normalized balance sheet and income statement for the Subject by removing any non-operating revenues and expenses and any non-operating assets and liabilities. The valuation methodologies that are used in this report produce a value for the company’s operating assets only. Accordingly, after calculating the value of the Subject’s operating assets, we must add back the value of all the non-operating assets and liabilities that were removed in the normalizing process. Thus, the final value for the Company will be for the total of its assets regardless of whether or not they were essential to the income-producing operations of the business.

Exhibit XIV Peer Group Ratio Analysis - 2010 to 2014

FINANCIAL RATIOS	HiTech Precision Sheetmetal, Inc.									
	2014		2013		2012		2011		2010	
	Industry	Subject	Industry	Subject	Industry	Subject	Industry	Subject	Industry	Subject
Cash to Revenue Ratio	6.3%	5.2%	6.3%	16.7%	7.6%	2.5%	8.7%	5.6%	7.6%	0.7%
Receivables Turnover (Times)	7.6 x	7.6 x	7.6 x	11.8 x	6.6 x	6.0 x	5.7 x	5.2 x	5.9 x	5.2 x
(Days)	48 days	48 days	48 days	31 days	55 days	61 days	64 days	70 days	62 days	70 days
Inventory Turnover (Times)	9.5 x	12.50	9.5 x	21.44	7.3 x	8.31	7.1 x	7.48	8.6 x	7.32
(Days)	39 Days	29 Days	39 Days	17 Days	50 Days	44 Days	51 Days	49 Days	42 Days	50 Days
Payables Turnover (Times)	11.9 x	5.7 x	11.7 x	22.9 x	11.5 x	7.6 x	8.7 x	3.6 x	10.6 x	6.9 x
(incl. credit cards) (Days)	31 days	64 days	31 days	16 days	32 days	48 days	42 days	102 days	34 days	53 days
Working Capital Turnover	6.3 x	10.4 x	6.5 x	5.0 x	4.9 x	7.2 x	4.8 x	6.7 x	5.0 x	8.7 x
Net Fixed Asset Turnover	11.9 x	11.6 x	11.8 x	8.3 x	9.5 x	7.3 x	9.9 x	5.8 x	8.7 x	6.5 x
Gross Fixed Asset Turnover	4.0 x	3.5 x	4.0 x	3.3 x	3.2 x	3.3 x	3.4 x	3.1 x	2.9 x	3.4 x
Total Asset Turnover	2.3 x	2.8 x	2.3 x	2.4 x	2.0 x	2.4 x	1.7 x	2.0 x	1.8 x	2.3 x
Debt to Equity Ratio	0.7 x	1.2 x	0.7 x	0.6 x	0.6 x	1.9 x	0.7 x	2.3 x	0.7 x	1.5 x
TOTAL INVESTED CAPITAL STRUCTURE										
Total Int Bearing Debt to Total Invested Capital	20.9%	27.8%	21.8%	18.3%	20.2%	42.5%	18.4%	51.7%	22.8%	36.4%
Net worth to Total Invested Capital	79.1%	72.2%	78.2%	81.7%	79.8%	57.5%	81.6%	48.3%	77.2%	63.6%
IB Debt to Equity Ratio	0.264	0.386	0.278	0.224	0.253	0.738	0.225	1.069	0.295	0.572
Receivables Turnover (Times) = Total Revenue / Accounts Receivable	Receivables TO (Days) = 365 / Receivables TO (Times)									
Inventory Turnover (Times) = Cost of Goods Sold / Inventory	Inventory Turnover (Days) = 365 / Inventory TO (Times)									
Payables Turnover (Times) = COGS Purchases / Accounts Payable	Payables Turnover (Days) = 365 / Payables TO (Times)									
Working Capital Turnover = Total Revenue / (Cur Assets - Cur Liabilities)	Total Asset Turnover = Total Revenues / Total Assets									
Net Fixed Asset Turnover = Revenues / (FF&E - Accumulated Depr)	Gross Fixed Asset TO = Revenues / FF&E before depreciation									
Debt to Equity Ratio = Total Liabilities / Total Net Worth	Total Interest Bearing Debt to Total Invested Capital =									
Net Worth to Total Invested Capital =	(Short-Term + Long-Term Int Bear Debt) /									
Net Worth / (Net Worth + Short-Term + Long-Term Int Bear Debt)	(Short-term + Long-Term Int Bear Debt + Net Worth)									

4.3.1 CASH

From the Common Size Balance Sheet in Exhibit XIII above, from 2010 to 2014 the Company's cash balances averaged 14.8% of total assets compared to the industry's 14.7%. The Subject's cash balances declined to 14.5% in 2014 while the industry was nearly the same at 14.7%. It would appear that the Subject carries an adequate level of cash compared to its peers. However, from the ratio analysis, in terms of revenue production, the Subject's cash balances averaged 6.1% of revenues over the last five years which is slightly below the industry's 7.3% average. However, in 2014 cash balances slipped to 5.2% of revenues, whereas the industry carried cash equal to 6.3% of revenue. That means for every \$1,000 increase in revenues, the Subject only needs an additional \$52 in cash, whereas, the peer group needs \$63.

Analysis: Thus, from the production of income point of view, the Subject's cash balances are roughly in line with its peer group. If HiTech carried the same level of cash for its given level of revenues as the industry average, it would need \$1,136,000 (7.3% x \$15,555,595) to operate the business. The Company carried \$814,074 as of fiscal year-end 2014 which is within a reasonable level of the peer group. As such, there is no excess cash being held by the company.

4.3.2 ACCOUNTS RECEIVABLE TURNOVER (Revenues ÷ Accounts Receivable)

The Bizminer companies turned their accounts receivable an average of 6.69 times per year (which equals every 55 days) from 2010 to 2014. HiTech turned its receivables an average of 7.17 times (56 days) during the same period. The current year's turnover for the Subject is 48 days which is the same as the peer group's 48 days.

The Company's receivables aging reveals a high concentration from two customers which is consistent with the level of revenue those two companies do with HiTech. The aging at year-end 2014 is as follows:

<u>Customer</u>	<u>Currently Due</u>	<u>30-60 days</u>	<u>60+ days</u>
Google	\$335,687	\$110,557	\$10,859
Mobile Materials	\$958,423	\$271,722	
All Others	\$141,844	\$112,924	\$103,380

Google and Mobile Materials appear to be reasonably prompt in paying their receivables. The smaller companies, however, are much slower, but losses over the last six years have been minimal.

Analysis: HiTech's accounts receivable do not pose any excess risk to long-term cash flow generation.

4.3.3 INVENTORY TURNOVER (Cost of Goods Sold ÷ Inventory)

The Subject's inventory turnover averaged 38 days (11.4 times per year) over the last five years compared to the industry's 44 days (8.4 times per year). The Company's turnover rate slowed to 29 Days by the 2014, which was moderately faster than the 39 Days experienced by the industry in 2014. The Subject buys raw materials from several local suppliers and can restock

is as little as two to three days' lead time. Sheet metal is a basic commodity that is readily available from many sources and pricing is reasonably competitive. HiTech can pass much of any market increase in metal prices onto its customers. Thus, there is little incentive to stockpile raw materials in excess of a few weeks' demand.

Analysis: HiTech's lower level of inventory gives it a modest long-term cash flow advantage over its peers.

4.3.4 ACCOUNTS PAYABLE TURNOVER

On the balance sheet, the Bizminer companies' accounts payable averaged 13.7% of total liabilities and net worth. HiTech averaged a nearly identical 13.3%. The Bizminer companies' accounts payable turned over an average of 34 days from 2010 to 2014. HiTech averaged 34 days during the same period.

The accounts payable are spread over 85 different vendors. The top three vendors only account for 38% of total outstanding debt. Nearly 90% of payables is current, 9% is 30 days past due, and only 1% is over 60 days past due.

Analysis: The Subject Company's payables turnover is identical to the industry and poses no risk to cash flow.

4.3.5 WORKING CAPITAL TURNOVER

Working capital is defined as total current assets less current liabilities. The Subject's working capital turnover (revenues divided by working capital) averaged 5.8 times compared to the peer group at 5.5 times. That means the subject is trying to generate more revenue for every dollar invested in working capital.

Analysis: The Subject's working capital investment is nearly identical to the peer group. Consequently working capital investment does not pose any additional risk to the company's future cash flow generation

4.3.6 FIXED ASSET TURNOVER (Revenues ÷ Gross Fixed Assets before Depreciation)

The Company's ratio of revenues to *NET* fixed assets (fixtures and equipment plus tenant improvements) averaged 7.37 times from 2010 to 2014 compared with the guideline companies 10.35 times during the same period. A modestly higher ratio can mean that a company uses its equipment more efficiently than its competitors do. However, a substantially higher ratio suggests that the company is under-invested in FF&E. A low investment in equipment could mean the equipment is older and not state-of-the-art, or that the company is working its equipment too hard to continually maintain its high level of output. The danger here is that equipment failures will result in large loss of revenue.

A more relevant measure of equipment investment is a company's *GROSS* fixed assets (the cost of fixtures and tenant improvements before the deduction of depreciation). Since the Subject

depreciates its fixtures rapidly, their net value on the books is quite low compared to their original cost. A high turnover ratio for FF&E means that for the same level of fixtures the Subject Company is trying to generate a much higher level of sales than the peer group. As was noted above, more than likely the high turnover rate suggests that the Company does not maintain an adequate level of fixtures, equipment, and computers necessary to sustain its current level of revenues. HiTech' five-year average gross fixtures turnover was 3.24 times compared to the guideline company average of 3.51 times. The spread in 2014 widened slightly with the Subject showing a turnover of 3.1 times compared to 4.0 times for the industry.

The lower ratio indicates that the Subject has a greater investment in fixtures and equipment than the Bizminer companies with respect to their levels of revenue. HiTech has invested heavily in state of the art machining equipment that is programmable and laser guided. The high equipment cost will require a greater level of replacement costs in the future which will absorb available cash flow. The trade off, however, is that the highly efficient equipment produces a considerable labor savings. As we observed in the section on revenue analysis, the Subject's gross profit margin after deducting labor costs is considerably higher than the peer group. The labor savings more than offsets the increase in capital expenditures from replacing old equipment.

Analysis: The Company's present level of fixtures, although moderately higher than the peer group, produces much higher levels of cash flow and, therefore, is a lower risk to future cash flow.

4.3.7 DEBT-TO-EQUITY RATIO

From 2010 to 2014 the Bizminer companies averaged a total debt of 0.7 times equity compared to HiTech's debt-to-equity ratio of 1.5 times. A significant portion of the high level of debt is to the shareholders of the company. This debt is just another form of equity investment made by an owner. In difficult economic times the owner would just stop making principal and interest payments to himself. Hence, this debt bears the same risk as equity. If the shareholder debt were added to net worth, the company's debt-equity-ratio would drop to 0.72 times equity. In other words, the company's actual debt-to-equity ratio is identical to the peer group.

Overall Analysis of Financials: The Subject's long-term debt-equity ratio is in line with the industry levels which will enable it to borrow in the future to take advantage of growth opportunities that may arise, giving it an advantage over its peers.

4.3.8 INVESTED CAPITAL RATIO

The industry interest-bearing debt and equity levels are important elements used in the Income Approach. In this analysis we focus on the industry's total capital consisting of interest-bearing debt (IB debt) and equity capital. Both of these forms of capital combined are referred to as Total Invested Capital. From Exhibit XIV above, total short-term and long-term IB debt averaged 3.74% and 12.07%, respectively of Total Liabilities and Net Worth, for a total of 15.8%. Net worth averaged 60.2% of Total Liabilities and Net Worth. The total of both forms

of Invested Capital, therefore, equals 76.0% of Total Liabilities and Net Worth. Thus, the percentage of IB debt to Total Invested Capital is 20.8% ($15.8\% / 76.0\%$) and the percentage of equity to Total Invested Capital is 79.2% ($60.2\% / 76.0\%$).

Analysis of Invested Capital: The industry IB-debt capital averaged 20.8% of Total Invested Capital and equity capital averaged 79.2%. The resulting Invested Capital debt-to-equity ratio is 26.3% ($20.8\%/79.2\%$). These three values will be used in the Income Approach in Section 6.0.

HiTech's Invested Capital debt-to-equity averaged 54.6% (excluding shareholder debt) from 2010 to 2014, more than double the peer group. However, the company has been rapidly reducing its outstanding debt. In 2014 its Invested Capital debt-to equity ratio was 38.6% which is a significant improvement, and just modestly higher than the peer group's 26.4%.

Overall Financial Statement Analysis: The ratio analysis comparing the guideline companies with the Subject found several areas of strength. The company has enjoyed better than average revenue and cash flow growth over the last five accounting periods. The company's gross profit margin-after-labor is moderately higher than the industry and its operating expenses are lower, thus enabling it to generate cash flow at a faster rate. The analysis of the Subject's balance sheet revealed that its level of cash and its accounts receivable, inventory, payables, and working capital turnovers are all in line with the peer group. The only area of weakness might be the high level of equipment investment and the slightly elevated level of debt as a result of the financing of all that equipment. However, as we noted, the equipment was producing substantial labor savings that more than offset the capital expenditures from replacing old equipment.

5.0 VALUATION OF THE SUBJECT BUSINESS

The methodologies considered for use in the valuation of the Subject are as follows:

ASSET APPROACH IS REJECTED. The Asset Approach is most frequently used for companies that are asset-intensive or are holding companies. These are companies that typically have low cash flow with respect to their level of assets. The Adjusted Book Value Method is commonly used in the Asset Approach to value the *tangible* assets of the Subject Company. The Subject Company does not produce a reliable balance sheet. Therefore, this methodology cannot be used.

EXCESS EARNINGS METHOD IS REJECTED. This approach is a sub-category to the Asset Approach. It is also referred to as the Formula Approach. The method is used to calculate the intangible value of a company which is then added to the Adjusted Book Value to obtain the total value of the business. It requires a fairly high-integrity balance sheet in order to calculate the return on investment attributed to the company's assets. Most small, privately held companies do not have accurate inventories on their balance sheets. In addition, much of their FF&E are fully depreciated or have been expensed rather than capitalized. As such the accountant typically does not include them on the company's balance sheet. As a result an unknown portion of the company's fixtures are unaccounted for and much of the rest has

questionable value. Any estimate would likely be inaccurate. Revenue Ruling 68-609 states that “The Formula Approach should not be used if there is better evidence available from which the value of intangibles can be determined.”¹³ The Appraiser believes that the Market provides better evidence of the appraisal value.

LIQUIDATION VALUE IS REJECTED. The Uniform Standards of Professional Appraisal Practice (USPAP) requires that the Appraiser consider the liquidation value of a business.¹⁴ The Subject Company is an on-going concern with over a 16-year history. It is currently very profitable. Thus, its future on-going concern value would be greater than its liquidation value.

INCOME APPROACH IS SELECTED. The Income Approach bases the value of the operating assets of a company on its ability to generate cash. Implicit in the approach is that a buyer will look at the cash flow a company generates, apply a desired rate of return, and thereby determine an appropriate amount to invest in the company.

The ability to generate cash for distribution to an investor is commonly referred to as the “dividend paying capacity” of a company. It is the level of cash flow after all expenses, taxes, and balance sheet demands have been met that can be distributed to an investor without impairing future operations. The dividend paying capacity of a company represents the “take-home” dollars that can be distributed to an investor. It is not necessary that these funds be distributed to the owner; they merely have to be available to him.

The dividend paying capacity of a company, while not a valuation method in itself; is a factor the appraiser is directed to consider by Revenue Ruling 59-60.¹⁵ To that end the net free cash flow that we will develop to be used with the Duff and Phelps model is the net profit after working capital requirements, capital expenditures and after all entity taxes (section 6.2). Thus the dividend paying capacity is effectively covered by that method.

MARKET APPROACH IS SELECTED. The Market Approach employs the Principal of Substitution. Simply stated, a buyer will not pay more for a business if an equally desirable substitute is available at a lesser price. Thus, in the Market Approach we search for what are considered equally desirable companies and use their selling prices to estimate the value of the Subject Company.

6.0 INCOME APPROACH

One of two different methods is typically used in the Income Approach. The first method used in the Income Approach is referred to as the Multi-Period Discount Method. This method is used when revenue and cash flow projected for the first few years have a number of anomalies

¹³ U.S. Internal Revenue Service, Revenue Ruling 68-609, (1968), p.1, <http://www.atig.com/Documents/Revenue/RevRule68-609.pdf>

¹⁴ Uniform Standards of Professional Appraisal Practice, The Appraisal Foundation, Washington D.C. 2010-2011 Edition, Standards Rule 9-3, http://www.uspap.org/USPAP/stds/sr9_3.htm

¹⁵ U.S. Internal Revenue Service, Revenue Ruling 59-60. (1959), Section 4, p.2 http://www.hantzmonwiebel.com/live_data/documents/ruling-59-60.pdf

that will not occur beyond that period, or the expected revenue stream will be highly volatile. This criterion does not fit the Subject Company; therefore, this method is rejected.

The second method is referred to as the Single Period Capitalization Method. The basic assumption underlying this method is that a single year's projected cash flow can serve as a proxy for all future cash flow. There are no expectations of unusual events or non-recurring income or expenses. The Subject fits this description; therefore, this method will be used.

The Single Period Capitalization Method will be broken down into the following five steps:

- 1) The Company's current P&Ls and balance sheet will be recast to reflect a "normalized" level of current operations (Paragraph 6.1).
- 2) This normalized level of operations will serve as a proxy for current earnings which will be used to project the company's Net Free Cash Flow to Equity (NFCFe) for the single period. NFCFe is that cash flow that is available to the equity interests (owners) after all income statement and balance sheet obligations have been met.
- 3) An appropriate Discount Rate (Rate of Return) for the appraisal subject will be developed. (Paragraph 6.3)
- 4) The long-term Perpetual Growth Rate is estimated from which the Capitalization Rate can be calculated (Paragraph 6.4)
- 5) The final step is to capitalize the NFCFe income stream, i.e. divide the income stream by the capitalization rate, to determine the market value of the Subject's net worth.

It is important to note that the normalizing adjustments will be made from a 100% controlling owner's perspective. As such, the value that the methodology above will initially develop is on a 100% controlling basis. We established in the introduction of this report that we are seeking a controlling basis valuation. Thus, the methodology we are using aligns with the controlling interest characteristic of our subject.

6.1 NORMALIZED HISTORICAL BALANCE SHEET

Normalizing adjustments to the balance sheet are intended to re-state entries from book value to fair market value as of the date of valuation. In addition, assets and liabilities that are identified as non-operating in nature (that is, not essential for the production of income) are removed from the Normalized Balance Sheet because the Income Approach only determines the value of a company's operating assets. After the final operating value is determined by the Income Approach, the fair market value of the non-operating assets and liabilities are added back to arrive at the total value of the Subject's net worth. The adjustments for the Subject Company balance sheet are illustrated in the following exhibit, with explanations given in the paragraphs indicated.

Exhibit XV Normalized Balance Sheet

HiTech Precision Sheetmetal, Inc. December 31, 2014			See Para.	
Assets	12/31/2014	Adjustments	Normalized	
Cash and Equivalent	814,000	-	814,000	6.1.1
Accounts Receivable	2,045,000	-	2,045,000	
Inventory-Raw Materials	466,000	-	466,000	
Inventory-Work in Process	80,000	-	80,000	
Inventory-Finished Goods	180,000	-	180,000	
Employee Receivables	81,000	-	81,000	
Due From Shareholder	100,000	(100,000)	-	6.1.2
Prepays, Deposits	85,000	-	85,000	6.1.3
Total Current Assets	3,851,000	(100,000)	3,751,000	
Fixtures & Equipment	4,679,000	(869,000)	3,810,000	6.1.4
Depreciation	(3,070,000)	3,070,000	-	6.1.4
Tenant Improvements	409,000	(49,000)	360,000	6.1.4
TI-Depreciation	(269,000)	269,000	-	6.1.4
Lease Deposits	-	-	-	
Total Assets	5,599,000	2,321,000	7,920,000	
Accruals	294,000	-	294,000	6.1.3
Rent Payable	-	-	-	
Credit Cards	20,000	-	20,000	
Accounts Payable	683,000	-	683,000	
Notes, Lines of Credit	375,000	-	375,000	
Total Current Liabilities	1,372,000	-	1,372,000	
Long-Term Debt	629,000	-	629,000	
Deferrred Taxes	10,000	-	10,000	
Due to Shareholder	984,000	(984,000)	-	6.1.2
Total Liabilities	2,996,000	(984,000)	2,012,000	
Net Worth	2,604,000	3,305,000	5,909,000	

6.1.1 CASH

Cash is generally carried to the Normalized Balance Sheet at full value. The exception would be in cases where the company carries higher levels of cash than are necessary to run the company. Excess cash would be considered a non-operating asset that would be removed from the Normalized Balance Sheet and then added back to the final value calculated under the Income Approach.

As we learned in section 4.3.1 of the ratio analysis, the Subject Company's level of cash is considered to be at a reasonable level. Therefore, no adjustment is necessary. The full amount of cash is carried to the Normalized Balance Sheet.

6.1.2 DUE FROM AND DUE TO SHAREHOLDER

Shareholder loans to and from the corporation are treated as other forms of shareholder capital. They are removed from the Normalized Balance Sheet which effectively adds loans from the shareholder to the net worth of the company and deducts loans to shareholder from net worth.

6.1.3 PREPAIDS AND ACCRUALS

Prepaid expenses, deposits, and accrued liabilities are considered ordinary and necessary assets and liabilities of an on-going concern. HiTech's prepaids are prepaid insurance and prepaid 401K contributions. Its accrued expenses are taxes payable and various payroll accrued expenses. Thus, prepaid expenses and accruals are carried at full value to the Normalized Balance Sheet.

6.1.3 FURNITURE, FIXTURES, AND EQUIPMENT

The tax return depreciation schedule will be used in the fixtures and equipment analysis.

Most of the Subject's fixed asset items have been fully depreciated and have a higher market value than their book value. The fixed assets were restated to fair market value under the premise that the Company is an *on-going concern* and its fixed assets are *in place, in use, and generating profits*. In other words, the fixed assets have a far greater value to the Subject than if they were, say, sold piecemeal on eBay. For example, a used computer probably would bring less than two hundred dollars if sold on eBay. However, to the Subject, that computer represents many hours of tech labor to install all the software, network to the rest of the office computers, debug, and customize. More importantly, it may have taken hundreds of hours to input all the data that is contained in its memory. That computer is technically worth thousands of dollars to the Subject.

Shannon Pratt describes a common method used to value the fixtures and equipment of an on-going concern referred to as the "depreciated replacement cost method."¹⁶

The replacement cost of each asset on the Company's depreciation ledger was calculated by adjusting its original cost by inflation to equal a current dollar value and then, that value was prorated by its remaining life. The furniture and fixtures were assumed to have a fifteen year life, equipment a twenty year life, vehicles a fifteen year life, computers and software a seven year life. Accumulated Depreciation was then removed from the Balance Sheet.

¹⁶ Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweihs, Valuing Small Businesses and Professional Practices, 3rd edition (New York, NY: McGraw-Hill, 1998), p. 106

The table below shows the replacement cost adjustment factors used to prorate the remaining value of an asset adjusted by inflation. For example, a \$100 desk purchased in 2009 would have an expected life of ten years. The equivalent replacement cost today adjusted for inflation would be \$109.40 (\$100 x (1+ 9.4%). However, its prorated life remaining (using mid-year convention) is 70.0%. The adjusted replacement cost value is \$76.58 (\$109.40 x 70.0%).

Replacement Cost Factors											
Year	Cumulative Inflation	Computers, Software 7 Year Life		Furniture & Fixtures 15 Year Life		Machinery & Equip. 20 Year Life		Vehicles 15 Year Life		Tenant Improvements 25 Year Life	
		7 Year Life	Factor	15 Year Life	Factor	20 Year Life	Factor	15 Year Life	Factor	25 Year Life	Factor
2014	1.7%	92.9%	94.5%	96.7%	98.4%	97.5%	99.2%	96.7%	98.4%	98.0%	99.7%
2013	3.2%	92.9%	95.8%	96.7%	99.8%	97.5%	100.6%	96.7%	99.8%	98.0%	101.1%
2012	5.3%	78.6%	82.7%	90.0%	94.8%	92.5%	97.4%	90.0%	94.8%	94.0%	99.0%
2011	8.4%	64.3%	69.7%	83.3%	90.4%	87.5%	94.9%	83.3%	90.4%	90.0%	97.6%
2010	10.1%	50.0%	55.0%	76.7%	84.4%	82.5%	90.8%	76.7%	84.4%	86.0%	94.7%
2009	9.7%	35.7%	39.2%	70.0%	76.8%	77.5%	85.1%	70.0%	76.8%	82.0%	90.0%
2008	13.6%	21.4%	24.3%	63.3%	71.9%	72.5%	82.3%	63.3%	71.9%	78.0%	88.6%
2007	16.4%	7.1%	8.3%	56.7%	66.0%	67.5%	78.6%	56.7%	66.0%	74.0%	86.2%
2006	19.7%	0.0%	0.0%	50.0%	59.9%	62.5%	74.8%	50.0%	59.8%	70.0%	83.8%
2005	23.0%	0.0%	0.0%	43.4%	53.3%	57.5%	70.7%	43.3%	53.3%	66.0%	81.2%
2004	25.7%	0.0%	0.0%	36.7%	46.1%	52.5%	66.0%	36.7%	46.1%	62.0%	77.9%
2003	28.0%	0.0%	0.0%	30.0%	38.4%	47.5%	60.8%	30.0%	38.4%	58.0%	74.2%
2002	29.6%	0.0%	0.0%	23.4%	30.3%	42.5%	55.1%	23.3%	30.2%	54.0%	70.0%
2001	32.4%	0.0%	0.0%	16.7%	22.1%	37.5%	49.6%	16.7%	22.1%	50.0%	66.2%
2000	35.8%	0.0%	0.0%	10.0%	13.6%	32.5%	44.1%	10.0%	13.6%	46.0%	62.5%
1999	38.0%	0.0%	0.0%	0.0%	0.0%	27.5%	37.9%	10.0%	13.8%	42.0%	57.9%
1998	39.5%	0.0%	0.0%	0.0%	0.0%	22.5%	31.4%	10.0%	14.0%	38.0%	53.0%

The actual cost of the assets on the Company's fixtures and equipment ledger adjusted by the above factors yields the replacement cost value as follows:

Exhibit XVI Normalized Fixtures and Equipment

Year	Grand Totals		Computers, Software 7 Year Life		Furniture & Fixtures 15 Year Life		Machinery & Equip. 20 Year Life		Vehicles 15 Year Life		Tenant Improvements 25 Year Life	
	Ledger Totals	Adjusted Totals	Ledger Totals	Adjusted Totals	Ledger Totals	Adjusted Totals	Ledger Totals	Adjusted Totals	Ledger Totals	Adjusted Totals	Ledger Totals	Adjusted Totals
Totals	5,254,063	4,157,697	117,316	43,172	22,096	10,859	4,664,502	3,724,213	41,132	20,375	409,017	359,078
2014	83,973	81,985	23,431	22,062		0	47,252	46,716		0	13,290	13,207
2013	202,493	203,086		0		0	202,493	203,086		0		0
2012	62,718	59,748	7,740	6,382		0	54,978	53,366		0		0
2011	1,014,321	955,887	13,420	9,324		0	1,000,901	946,563		0		0
2010	194,027	177,901		0		0	134,910	122,119		0	59,117	55,782
2009	77,174	65,431		0		0	77,174	65,431		0		0
2008	197,561	167,273	6,705	1,627		0	46,456	38,131		0	144,400	127,515
2007	1,152,543	876,569	45,556	3,777	8,690	5,720	1,012,437	793,316		0	85,860	73,756
2006	1,082,289	809,156	9,907	0		0	966,032	720,338		0	106,350	88,818
2005	836,018	580,986	7,298	0		0	808,278	570,120	20,442	10,866		0
2004	45,132	23,447	3,259	0		0	21,183	13,939	20,690	9,509		0
2003	158,024	92,816		0	13,406	5,139	144,618	87,677		0		0
2002	31,365	17,227		0		0	31,365	17,227		0		0
2001	0	0		0		0	0	0		0		0
2000	34,493	15,180		0		0	34,493	15,180		0		0
1999	81,932	31,005		0		0	81,932	31,005		0		0
1998	0	0		0		0	0	0		0		0

The total current estimated market value for the fixtures, equipment, computers, and vehicles on an on-going concern basis is \$3,799,000. The value of tenant improvements is \$359,000. The normalized balance sheet in Exhibit XV above is adjusted to reflect this estimate. Depreciation is also removed from the Normalized Balance Sheet.

Analysis: The combined adjustments described above increase the market value of HiTech Precision Sheetmetal, Inc.'s net worth (i.e. its book value) from \$2,996,000 \$5,599,000 to \$5,599,000 \$7,908,000.

6.2 NORMALIZED INCOME STATEMENT

One of the first steps in the working through the Income Approach is the selection of the data source to be used in estimating an investor's desired rate of return. The database used in this analysis is taken from the Duff and Phelps Valuation Handbook which employs the buildup method of risk assessment.¹⁷ Duff and Phelps' buildup method uses the rates of return on investments observed from publicly traded companies listed on the various national stock exchanges. (This will be discussed further in Paragraph 6.3.) Thus, the subject's income statement must be recast in a manner that yields a level of cash flow that is consistent with what we find in publicly traded companies. As such, we must eliminate various anomalies and non-recurring events affecting the Subject's income stream because the Duff and Phelps' database is a collection of publicly traded companies, some with non-recurring gains and some with non-recurring losses. The rate of return exhibited from this collection of publicly traded companies, then, reflects an average of all those non-recurring gains and losses which in essence offset each other.

Public companies are also essentially run by managers whose salaries are dictated by the marketplace rather than by a majority owner of a privately held company who pays himself whatever he wishes. Thus, the normalizing process calls for removing the owner's salary and benefits from the income stream and substituting the market value of the salary and benefits for a hypothetical manager. The final element of recasting produces the net cash flow after working capital requirements, capital expenditures and after all entity taxes.

[It should be noted that each of the various Approaches used throughout this report will reconstruct the Subject's income statement in a different manner to arrive at some measure of cash flow. The reason is that the various databases that we use to draw comparisons to the Subject have chosen to reconstruct the income statements in different manners. In each case we are merely reconstructing the Subject's income statement to be directly comparable with the database presentation.]

6.2.1 PERIOD OF OBSERVATION

HiTech's primary customer is Google, a high-tech company with numerous large-scale projects underway at any point in time. As Google develops new products or markets, it uses

¹⁷ 2014 Duff and Phelps, "Valuation Handbook, Guide to Cost of Capital," Duff and Phelps, LLC., Chicago, Ill., ch. 2-8

Exhibit XVII Normalized Income Statement

	5 Year Average	Dec 31, 2010 to 2014	Normalized Adjustments	See Para.
INCOME				
Sales		15,839,932	-	
Freight, Design		12,249	-	
TOTAL INCOME		15,852,181	-	6.2.1
COST OF GOODS SOLD				
Beginning Inventory		1,005,270	-	
Raw Materials		5,298,097	-	
Work-in-Process		296,763	-	
Finished Goods		212,944	-	
Ending Inventory		(877,991)	-	
Net Purchases		5,935,083	-	
Direct Mfg. Labor		2,179,735	-	
Direct Subcontract Labor		179,277	-	
Direct Overhead		68,047	-	
Allocated Costs		-	-	
Indirect Labor		1,114,376	-	
Shop Supplies		275,660	-	
TOTAL COST OF GOODS SOLD		9,752,178	-	
GROSS PROFIT		6,100,003		
		38.5%		
OTHER INCOME				
Expedite Charge		9,147	-	
NR Charge		9,086	-	
Other Income		26,369	-	
Gain (Loss) Sale of Assets		25,815	(25,815)	6.2.3
Purchase Discounts, Interest		7,455	-	
TOTAL OTHER INCOME		77,873	(25,815)	
EXPENSES				
Compensation to Owner		545,433	139,743	6.2.2
Payroll Expense		857,764	-	
Commission Expense		14,332	-	
Accrued Vacation		(4,426)	-	
Repairs and Maintenance		112,375	-	
Bad Debts		5,309	-	
Rent		635,614	635,614	6.2.3
Market Rent @\$5,000,000 Value		-	(345,215)	6.2.3
Executive Expenses		6,336	6,336	6.2.2
Payroll Taxes		394,381	16,560	6.2.2
Pension Contribution 401K		9,666	812	6.2.2
Advertising		2,998	-	
Donations, Gifts, Awards		5,431	5,431	6.2.4
Sales Tax		25,436	-	
State Income Taxes		960	960	6.2.4
Taxes, Licenses and Permits		5,183	-	
Depreciation, Amortization		421,107	(44,542)	6.2.4
Property Taxes		32,635	(34,365)	
Interest Expense, Penalties		58,699	7,166	6.2.4
Outside Services		1,382	-	
Auto Expense		47,221	9,444	6.2.2
Bank and Credit Card Charges		5,818	-	
Insurance		27,842	-	
Health Insurance		323,498	9,856	6.2.2
Workman's Comp		210,451	-	
Professional Services		403,142	-	
Office Expense, Printing		44,957	-	6.2.3
Sm Computer Equipment		18,717	-	6.2.3
Misc., Dues, Training		10,525	-	
Operating Expense		15,740	-	
Company Event		8,087	-	
Travel and Entertainment		24,808	9,923	6.2.2
Employee Meals		13,322	-	
Supplies		43,397	-	
Freight & Shipping, Postage		339,747	-	
Expedite Fee (Moving Expense)		5,084	-	
Small Tool Expense		4,349	-	
Utilities		203,920	-	
TOTAL EXPENSES / Total Add-Backs		4,881,239	417,723	
Total Income per Tax Returns/P&Ls		1,296,636		
			391,908	
			1,688,544	
			466,566	6.2.5
Normalized Income After Entity Taxes =			1,221,978	

HiTech's services in its manufacturing process. It is common for the size of these projects to overwhelm HiTech's production capacity. Mr. Smith notes that he has continually tried to diversify his company by attracting new customers. However, Google's large projects frequently absorb most of the HiTech production capacity making it difficult to take on new large-sized customers. These large projects from Google occur randomly and the profitability of each can vary significantly. As such an average of the last five years' operations will give us the best view of the overall relationship HiTech has with Google.

Exhibit XVII shows the normalizing adjustments to HiTech Precision Sheetmetal, Inc.'s P&Ls for the selected period of observation. Discussions of these normalizing adjustments can be found in the paragraphs that are noted to the right of the item. The valuation of the Subject is as of December 31, 2014.

6.2.2 HYPOTHETICAL MANAGER'S COMPENSATION

The normalizing process calls for adjusting all owners' actual compensation to reflect a reasonable compensation level of salaried managers who would replace the owners in the business. The intent here is to restructure the Subject Company P&L's to replicate a passive ownership position similar to an investor on the stock market.

In the case of HiTech, John Smith and Jane Smith are full-time managing owners of the company. Mr. Smith functions as the company's CEO and Jane Smith functions as its CFO.

Therefore, a hypothetical CEO-President for the company would essentially replace Mr. Smith and Jane Smith would have to be replaced with a salaried employee. Consequently, the salaries

and benefits of both owners will be added back to normalized earnings and the hypothetical replacement CFO's salary will be deducted.

Payscale, Inc., a national payroll data service, was used to estimate the market rate of the salary for a hypothetical CFO. The report can be found on Page 124. Payscale, Inc. indicated that a salaried CFO of a company this size would currently earn \$138,000. This amount was reduced by 2.5% per year for each of the preceding four years to account for wage inflation, producing a five-year average salary of \$131,430. John Smith and Jane Smith drew an average combined salary over the last five years of \$545,433. This amount is added back to cash flow and the average replacement salary for a CFO of \$131,430 is *DEDUCTED* for a net add back of \$414,003. In addition, the payroll taxes and company benefits associated with their salaries are also added back: payroll taxes are \$16,560, travel and meals benefits \$9,923, pension benefits \$812, auto benefits \$9,444, health insurance \$9,856, and miscellaneous executive expenses are \$6,336.

Payscale, Inc., a national payroll data service, was used to estimate the market rate of the salary for a hypothetical CEO. The report can be found on Page 124. Payscale, Inc. indicated that a salaried CEO/President of a company this size would currently earn \$240,000 plus benefits. This amount was reduced by 2.5% per year for each of the preceding four years to account for wage inflation, producing a five-year average salary of \$228,540.

Mr. Smith indicated that the senior employees earn health and pension benefits of approximately 15% of their salaries plus payroll taxes averaging 5%. Thus, benefits and taxes for a hypothetical CEO would be approximately \$48,000 in 2014 and 2.5% less per year in each of the preceding years for a five-year average of \$45,720. The hypothetical manager's salary and benefits are *DEDUCTED* from normalized cash flow.

The net add back for Compensation to Owners and Managers is \$139,743 (\$545,433 - \$131,430 - \$228,540 - \$45,720). The adjustments for actual salary and benefits and the hypothetical replacement salary and benefits for all five years observed are itemized in detail on the notes to the P&Ls on Page 107.

6.2.3 NORMALIZING ADJUSTMENTS

6.2.3.1 NORMALIZED RENT

The real estate from which HiTech operates is owned by another company that is wholly owned by Mr. Smith. Special circumstances arise in this situation that affect the value of a business. Mr. Smith estimated that the fair market value of the property is \$5,000,000. A hypothetical buyer of the business would finance the purchase of the property and the resulting debt service is estimated at \$345,215. This amount is *DEDUCTED* from normalized cash flow and the actual rent paid to Mr. Smith's LLC is added back to cash flow. Detailed information on the calculation of the market value of rent can be found on Page 107, cell e43.

6.2.3.2 NORMALIZED INTEREST

The normalized P&Ls are adjusted for the current and projected interest-bearing debt that the company will incur. Calculations for the company's projected debt are discussed in depth in section 6.2.5.3 below. An add back of \$7,166 is made to normalized cash flow to reflect the reduced cost of interest.

6.2.3.3 DEPRECIATION

It is assumed that a business owner will attempt to maximize any depreciation benefits available to his company. Thus, all fixtures that are acquired will be fully depreciated in the year of acquisition. The current depreciation is adjusted for the long-term average depreciation that the company will enjoy. The (\$44,542) deduction increases depreciation to a net \$465,649. Section 6.2.5.3 will discuss the depreciation calculation used in the Normalized Income Statement above.

6.2.3.4 GAIN (LOSS) ON THE SALE OF ASSETS

Losses from the sale of assets of \$25,815 are non-recurring losses that are also non-operating in nature. Therefore, they are added back to normalized cash flow.

6.2.4 TAX RATE

Academics and the courts have wrestled with the concept of tax affecting the projected pre-tax income stream of a corporation when applying the Discounted Cash Flow (DCF) approach to valuing a business. Appraisal practitioners have long been trained by organizations such as the Institute of Business Appraisers to use an after-tax income stream when applying rates of return developed from publically traded investment data. However, the courts and the IRS have been slow to adopt the practice.

Gross v. Commissioner became a benchmark case in 1999 when the trial judge found in favor of the IRS appraisal expert who did not tax (i.e. applied a 0% tax rate) the projected income stream of an S-corporation, citing that S-corporations pay no entity taxes. The taxpayer's expert applied a 40% C-corp tax rate citing, among other things, that it was a generally accepted practice in the valuation community and that it had been "approved" in *Hall v. Commissioner* and *Maris v. Commissioner*. The 6th circuit court of appeals affirmed the 0% tax rate; however, the dissenting judge opined that applying a 0% tax rate did not accurately reflect the fair market value of the stock as determined under the willing buyer/willing seller standard. The inference was that a 0% tax rate would overvalue the corporation and a 40% tax rate would undervalue it. Thus the appraisal community and future courts were challenged to find a solution.

In 2000 a lower court decision in the *Bernier v. Bernier* divorce held that a hypothetical 35% C-corporation tax rate on the subject S-corporation's projected earnings submitted by the husband's appraiser was appropriate and threw out the valuation by the wife's appraiser which used a 0% tax rate. The subsequent appeals court decision in September 2007 upheld the tax-affected valuation but noted that the court case of *Delaware Open MRI Radiology Assocs. v.*

Kessler that was recently handed down mentioned that applying the C-corporate tax rate to an S-corporation severely understated its value and a 0% tax rate severely overstated its value. The Bernier judge recommended adopting the methodology advanced by the *Kessler* judge (discussed on the following page) for calculating an appropriate tax rate to apply to projected earnings.

The companies making up the Duff and Phelps database, which is used in this analysis, are all publicly traded C-corporations that pay taxes at the corporate level. However, determining the value of an S-corporation is a little trickier, because the taxes are passed through to the individual level (i.e. no taxes on the business income at the corporate level). Regardless, the concept of “usable income” flowing to the shareholder still applies.

The S-corporation can only reinvest and use for growth income that is available after taxes on business profits have been satisfied. The fact that it has to pay those income taxes via its shareholders makes no difference to the S-corporation’s value proposition. An S-corporation may have an advantage with respect to the avoidance of dividend and capital gains taxes that public-market investors pay. The valuation practitioner should evaluate each case individually to determine what adjustments, if any, should be made.

Since the Duff and Phelps database is derived from the public market companies, the data includes the effects of those taxes. Thus for proper comparison purposes, tax affecting a company’s earnings is appropriate in this circumstance. However, we must look at the possibility that, in the event that the Subject is an S-corporation, the Subject’s final S-corporate tax rate may be different from a C-corporation’s when all levels of taxes are considered.

The basis of the discussion on whether or not to tax affect projected S-corporate income is enconced in the fact that on a number of different levels S-corporate taxes are different from C-corporate taxes. Investors generally will elect to be taxed as an S-corporation because of the potential for reducing taxes and thereby increasing their net cash flow. The *Kessler* court felt that if an S-corporate structure produces a material increase in economic benefit to the stockholder, it should be given proper weight in the valuation of the stockholder’s interest. The court further noted that under an earnings valuation analysis, what is important to an investor is what he ultimately can keep in his pocket after taxes.

The Bernier and *Kessler* courts both focused on the double-taxation issue that exists with C-corporations. A C-corporate shareholder may withdraw the profits that remain after entity taxes are paid; however, he must pay an additional dividend tax on them at the personal tax level. Thus if the C-corporation’s combined state and federal taxes took 40% of its profits and a shareholder withdrew the remaining 60% of after-tax profits, he would have to pay an additional 21% dividend tax (state and federal) on the withdrawn amount on his personal taxes. The cash left for the shareholder after corporate and personal taxes would be 47.4% [$60\% \times (1-21\%)$]. An S-corporation, however, pays no entity tax; all taxes are borne by the shareholder. Thus if the stockholder’s personal state and federal tax bracket is 40%, he may elect to withdraw 100% of the company profits, pay the 40% tax, and keep the remaining 60%. There is no dividend tax for excess profit distributions of an S-corporation. In this example, the S-corporation tax structure benefited the stockholder by 26.5% ($60\% / 47.4\%$).

The Kessler judge ruled that using the C-corporation tax rate to value an S-corporation understated the value of the S-corporation by virtue of the differences in their total taxes. Thus he adjusted the hypothetical corporate tax rate to produce a net total tax that would be equivalent to what the S-corporate stockholder total rate would be. In this example the 60% retained by the S-corporate stockholder would have to be divided by one minus the dividend rate to determine an equivalent C-corporate tax rate: $[1 - (60\% / (1 - 21\%)) = 24.1\%]$. In other words, a 24.1% C-corporate tax rate less the shareholder's 21% dividend rate would leave him with the same 60% of profits that the S-corporate shareholder enjoyed.

Two important assumptions in the above example are the stockholder's personal tax bracket and how much of the company profits he plans to withdraw. Both these assumptions can vary greatly depending on individual circumstances which will result in significant differences in the ending tax rates. There are many other considerations that must be reviewed. Capital gains are also an issue. S-corporations are allowed to pass capital gains to the shareholder which are then taxed at a preferential 21% state and federal rate. C-corporations do not have a preferential capital gains tax rate and therefore, must pay nearly 40% state and federal taxes on that income. Thus one must consider the level of capital gains income the appraisal subject generates. The appraiser must also determine if there is danger of losing the S status in the near future. If the only pool of available buyers for the subject company is made up of C-corporations, such a sale would force the loss of S status. The majority shareholders may also arbitrarily elect to return to C status. A hypothetical sale of the business may be an Asset Sale instead of a Stock Sale. Thus the buyer's entity could be a C-corporation, proprietorship, etc. A hypothetical sale may also be in the form of a section 338(h)(10) tax-free stock exchange which likewise eliminates an S status.

The appraiser must consider all the facts surrounding the subject he is valuing when estimating the effective tax rate. The issues surrounding HiTech's "S" status are as follows:

- 1) The shareholders are highly compensated and the addition of S-corporate profits would put them near the top end of the personal income tax brackets which is a similar rate as the top end of the C-corporate tax brackets.
- 2) Since year-end 2009 the company's net worth increased \$1,002,900. Total earnings during the period were \$6,483,180. Thus, shareholders distributed \$5,480,280 or 84.5% of earnings to themselves. Thus, in this case, there is a potential dividend tax savings on the distributed profits.
- 3) Mr. Smith indicates that there are no intentions to eliminate the S status and there have been no prospective C-corporate buyers in the market.
- 4) The Subject had a minimal amount of capital gains income on its tax return for the last five years and any future capital gains are expected to be insignificant.

Based on the Company's normalized earnings observed during the past six years, the current personal tax rate for the shareholders will average 42.1% [36.4% for federal plus a net state rate after federal taxes of 5.7% (9.0% x (1-36.4%))]. Using the Kessler court methodology we find that the Company's equivalent C-corporate tax rate would be:

Adjustment for Equivalent C-Corp Tax Rate-2014 Income			
	Top End	Subject Actual	Equivalent
	C-Corp Taxes	S-Corp Taxes	C-Corp Taxes
Profits	\$100.00	\$100.00	\$100.00
State and Federal Corp Tax	39.8%	42.1%	27.6%
Available Earnings	\$60.20	\$57.90	\$72.37
94.0% Distributed to Sharehldrs	\$56.59	\$54.43	\$68.90
State and Federal Dividend Tax	21%		21%
Net to Shareholders after Div Tax	\$44.70	\$54.43	\$54.43
6% Net Retained by Corporation	\$3.61	\$3.47	\$3.47
Total Net Earnings After Double Taxes	\$48.32	\$57.90	\$57.90

The level of net income this company presently earns would put an equivalent C-corporation tax rate at 27.6% for state and federal taxes combined. [Note: total federal taxes on the above net income would average 23.9%. California state taxes would average 4.9%. However, since state taxes are a deduction on federal taxes, they reduce the federal tax burden. Therefore, the actual cost of the state tax after the federal tax deduction is equal to $(1 - 23.9\%) \times 4.9\%$ or 3.7% which yields a combined 27.6% tax rate.]

6.2.5 NORMALIZED CASH FLOW TO EQUITY

From the last line on Exhibit XVII we now have determined the level of the Subject's normalized income after entity taxes. The next step is to determine the amount of cash that was actually generated from that net income after tax. What we need to determine is amount of cash the company generated for the benefit of the equity holder of the company after all expenses and various balance sheet obligations are met. The available cash is referred to as Net Free Cash Flow to Equity (NFCFe). It is calculated by taking the net profit after entity tax, adding back depreciation and changes in interest-bearing debt and adjusting for changes in working capital and capital expenditures.

Exhibit XVIII Normalized Cash Flow to Equity

Normalized Cash Flow To Equity			Para.
From Exhibit XVII	Normalized Income after Taxes	1,221,978	6.2.5
	Plus: Depreciation	465,649	
	Increase (Decrease) in Interest Bearing Debt	26,645	6.2.5.3
	Less: Cash Outlays for Working Capital	(89,722)	6.2.5.1
	Less: Cash Outlays for Capital Expenditures	(368,794)	6.2.5.2
	Net Cash Flow to Equity-Current Year	1,255,756	
	Forecast Year with 5% Growth	62,788	6.2.5.4
	Projected Free Net Cash Flow to Equity	1,318,543	6.2.5.4

The calculations for projected Net Free Cash Flow to Equity as discussed below:

6.2.5.1 WORKING CAPITAL OUTLAYS

The growth in HiTech's sales will cause increases in various other balance sheet investments. As sales increase, cash balances, accounts receivable, and inventory (i.e. short-term assets) will increase. These necessary investments will be partially offset by (that is, be financed by) increases in accruals, accounts payable, and other short-term indebtedness. Short-term assets less short-term liabilities are referred to as working capital. As sales increase, a company's overall working capital investment often increases as well.

If a company currently has a negative working capital, that means as the company grows, current liabilities will grow faster than current assets. This decline in working capital will *create* cash for the company. It should also be noted that in years of a revenue decline, working capital investment will also decline in direct proportion which, in turn, *creates* a cash flow windfall.

If the formulas call for negative working capital growth in the projected year, it will be assumed that there will be no change in working capital into the future. In other words, it is not possible for working capital to decrease every year forever. If it did, at some point in time the company would have negative cash and inventory. Therefore zero growth is the reasonable alternative.

The Subject's current-year's working capital as per the Normalized Balance Sheet shown in Exhibit XV was \$2,379,000 (\$3,751,000 - \$1,372,000). Given our Perpetual Growth Rate of 5.0% (to be discussed in section 6.4), the normalized working capital for 2014 hypothetically grew by \$113,286 from the previous year [$\$2,379,000 - \$2,379,000/(1 + 5.0\%)$].

Over the long term, investments in working capital and capital expenditures will be financed with a combination of debt and equity. As we learned in Section 4.3.8, the industry's interest-bearing debt-to-equity ratio is 20.8% debt and 79.2% equity. The methodology we are using seeks to solve for Net Free Cash Flow to Equity. Thus, it is the equity holder's out-of-pocket outlays for working capital and capital expenditures that we are concerned with.

The equity holder's share of the investment in working capital is:

$$79.2\% \times \$113,286 = \$89,722$$

6.2.5.2 CAPITAL EXPENDITURES OUTLAYS

In calculating NFCFe it is necessary to determine the burden that capital expenditures will place on cash flow. As a company grows it will need increasingly larger amounts of working capital and plant and equipment to support the higher level of output. The Subject's current-year's fixtures and equipment as per the Normalized Balance Sheet shown in Exhibit XV was \$3,799,000. Given our Perpetual Growth Rate of 5.0%, that would suggest normalized fixtures in 2014 hypothetically grew \$180,905 from the previous year [$\$3,799,000 - \$3,799,000/(1 + 5.0\%)$].

Not only will the Subject need to increase its fixtures investment as the Company grows, it will also have to replace the existing fixtures as they wear out. As per Exhibit XVI we saw

that the Company's existing fixtures had a weighted average expected life of 19.6 years. Thus, we can expect that the Subject will have to replace \$234,941 of worn out fixtures each year ($\$3,799,000/[1 + 5.0\%]/19.6$ years).

Total normalized capital expenditures for fixtures and equipment for the current normalized year is therefore, \$415,846 ($\$180,905 + \$234,941$). As in the working capital analysis, we are seeking the equity holder's share of the investment in capital expenditures:

$$79.2\% \times \$465,649 = \$368,794$$

As noted in Section 6.2.3.3 the company will maximize its depreciation write-off each year. Thus, the entire fixtures investment of \$465,649 will be depreciated.

6.2.5.3 CHANGE IN INTEREST-BEARING DEBT

New debt represents an increase in cash to the company. Owners have the option of withdrawing borrowed cash from their company, but of course, the more common use is to purchase fixtures and equipment or fund working capital. Regardless, a controlling owner has that option.

Following that guideline, then, we note that as a company retains earnings each year, its net worth will increase. As its net worth increases, the company's debt will also increase in direct proportion to the industry average interest-bearing debt-equity ratio. As we saw from the balance sheet analysis in Exhibit XIII, the industry average interest-bearing debt to equity ratio is 26.3%. That means for every dollar of equity the industry carries, it also carries 26.3 cents in debt. Thus, if a company earns \$10,000 and retains those profits, the likelihood is that the company will also borrow \$2,630.

Since the Subject is an S-Corporation it is common practice for a portion of the net income before taxes to be distributed to the shareholder with the remaining earnings retained by the company. The company's income taxes will be paid by the shareholder using the earnings he distributed to himself. The portion of earnings retained by the company will enable it to borrow additional capital at the industry's given ratio of debt to equity. The combination of new debt and retained-earnings equity must be at least sufficient in amount to cover principal payments on existing debt, capital expenditures, and necessary increases in working capital. So in the case of the S-corporation owner, he must leave enough retained earnings in the company to cover these obligations. In the long run, it is assumed that all of the excess earnings after meeting these obligations will be distributed to the shareholders.

By trial and error iterations we determined that the owners of HiTech could take up to a 94.0% distribution from the Net Profits before Tax calculated in Exhibit XVII. (Over the past five years the shareholders of HiTech have distributed 84.5% of the company earnings before taxes to themselves.) The retained earnings of \$101,313 would enable the company to borrow \$26,645 at the industry's 0.263 Debt-Equity ratio. That coupled with \$465,649 in depreciation would give him enough cash flow to cover the total balance sheet expenditures of \$578,935.

	Cash In	Cash Out
Net Profits before Tax =	\$1,688,544	
Shareholder Distributions @ 94% =	-\$1,587,231	
Retained Earnings =	\$101,313	
Increased Debt @ D/E Ratio - 26.3% =	\$26,645	
Depreciation =	\$465,649	
Total Cash Available Flow =	<u>\$593,607</u>	
Total Working Capital Requirement =		\$113,286
Total Capital Expenditures =		<u>\$465,649</u>
Total Balance Sheet Expenditures =		<u>\$578,935</u>

From the above calculations, then, \$26,645 in increased debt is added to Net Free Cash Flow to Equity.

6.2.5.4 PROJECTED NET FREE CASH FLOW

From the compilation of all the above numbers we arrive at a normalized level of net free cash flow in the current year. The value represents the total Net Free Cash Flow to Equity (NFCFe); that is, the cash flow that is available to the equity holder of the Subject Company.

Since the Income Approach is based on projected earnings we will apply the expected long-term growth rate of the company (to be discussed in paragraph 6.4) to the current year's level of NFCFe.

Projected Net Free Cash Flow to Equity for HiTech is \$1,318,543 [$\$1,255,756 \times (1 + 5.0\%)$]

6.3 DISCOUNT RATE AND CAPITALIZATION RATE

The third step in the Single Period Capitalization Method calls for determining the appropriate rate of return, or Discount Rate, that a hypothetical investor might seek in acquiring the Subject. It is the estimate of the reasonable rate of return needed to attract the capital of a willing buyer in the marketplace given the level of risk inherent in the Subject Company. From that Rate of Return we can then calculate the Capitalization Rate.

The first step in the formulation of the Discount Rate is the selection of the data source to be used in estimating an investor's desired rate of return. As mentioned earlier, the database used in this analysis is taken from the Duff and Phelps Valuation Handbook which employs the buildup method of risk assessment. The buildup method is an additive model in which the appropriate return on an equity investment is estimated by summing up the risk-free investment

rate (we used the yield on U.S. Treasury 20-year Bonds suggested by Duff and Phelps) and any premiums for the additional risks that the investor is willing to absorb.¹⁸

The following table lists the components of the appropriate Rate of Return on the equity investment in the Subject. An explanation of each follows the table.

Exhibit XIX Build-up Method

Risk Free Rate (6.3.1)	2.47%
Equity Risk Premium (6.3.2)	6.18%
Small Company Risk Premium (6.3.3)	9.59%
Industry Risk Premium (6.3.4)	2.29%
Specific Company Risk Premium (6.3.5)	<u>5.00%</u>
Total Discount Rate (rounded)	25.5%

6.3.1 RISK FREE RATE - 2.47%

The Risk Free Rate is the rate one could receive for an investment that is free of capital risk. In other words, not only is the rate of return guaranteed, but also the return of the original investment is guaranteed. Duff and Phelps has used the 20-year United States Treasury Bond rate as the proxy for this component in the buildup method. The yield to be used will be the 20-year bond rate as of December 31, 2014, the date of this valuation.

Implicit in the Risk Free Rate is that the investor is also being compensated for the effects of inflation on the return of his capital. Investors will demand higher rates of return on U.S. bonds as they perceive that inflation is increasing. As will be discussed further below, the fact that the return on equity takes into account inflation, our forecast for the Subject's future income stream must also be matched in current dollars (i.e. including inflation) as will be the Subject's Perpetual Growth Rate.

Taken from: <http://research.stlouisfed.org/fred2/data/DGS20.txt>

6.3.2 EQUITY RISK PREMIUM - 6.18%

This represents the next level of risk typically associated with investing in a portfolio of large, freely-traded common stocks. From 1926 to 2013 the average yield in excess of the Risk Free Rate for stock market equities is 6.96% (rounded). This rate is reduced by 0.78% to 6.18% (rounded) to account for what is known as the "Supply Side" effect. Supply Side theory states that during the last 20 years a portion of stock market gains can be attributed to rising price-earnings ratios (P-E).¹⁹ Basically, investors have been increasingly bidding up prices during this period in expectation of future earnings growth. It is unlikely that businesses can continue to supply that expected increase in earnings growth, thus causing P-E ratios to level out. The

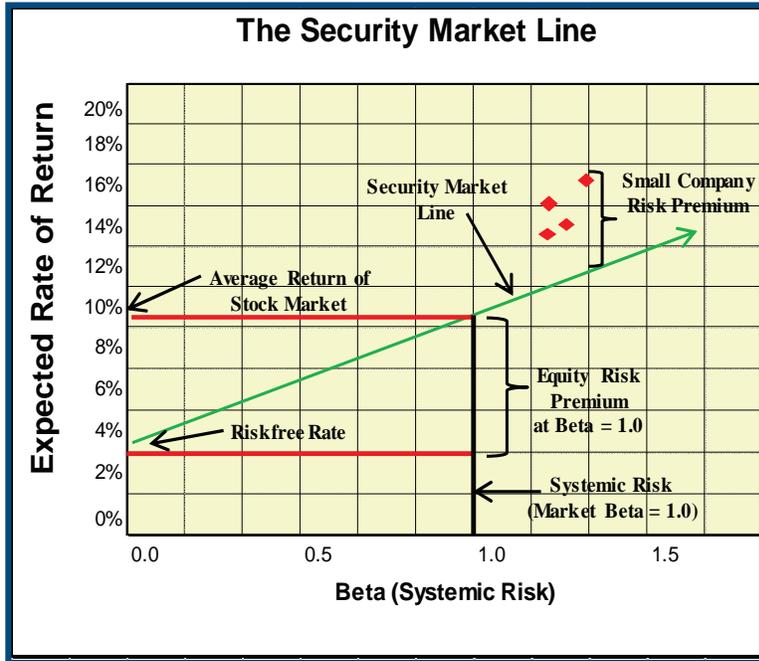
¹⁸ Duff and Phelps, "2014 Valuation Handbook, Guide to Cost of Capital," Duff and Phelps, LLC., Chicago, IL., p.3-1

¹⁹ Ibid., p.3-19

portion of gains on equities attributed to P-E growth will, therefore, disappear, which will in turn reduce the future long-term rate of return on equities.

Duff and Phelps - 2014 Valuation Handbook, Guide to Cost of Capital

6.3.3 SMALL COMPANY RISK PREMIUM - 9.59%



We have now established the return on a risk-free investment in U.S. Treasury bonds and the average annual rate of return for the stock market as a whole. The annual rate of return for the stock market varies from year to year and it is this volatility that represents the systemic risk present in the investment world. This systemic risk, or beta, affects all assets albeit with different magnitude. When comparing the volatility of a single asset with the volatility of the overall stock market, an asset whose annual return fluctuates up or down each year by exactly the same amount as the overall stock market is referred to having a beta

of 1.0. A less risky asset with a low level of volatility will be accorded a beta of less than 1.0 and a highly volatile asset will have a beta greater than 1.0. If we create a graph with the measure of volatility on the x-axis and rate of return on the y-axis, we can plot a line between the risk free investments and investments in risk-bearing equities of the stock market. By definition the stock market as a whole has a beta of 1.0 and its average rate of return from 1926 to 2013 is 9.9% (from paragraph 6.2.1 and 6.1.2). The risk free U.S. bonds have a beta of 0.0 and a return of 3.72%. This line, referred to as the Security Market Line, depicts the systemic risk or beta that affects the rate of return on all assets. In theory, all properly priced assets will fall on this line. Accordingly, we should be able to calculate the beta for an asset and plot it on the Security Market Line and determine its appropriate rate of return. The greater the risk we are willing to assume (i.e. the greater the beta), the greater the return on investment we should expect.

To analyze this “risk versus reward” effect, the entire universe of securities listed on the New York Stock Exchange (NYSE), American Stock Exchange (AMEX), and the Nasdaq National Market (NASDAQ) was filtered for just U.S. common stock equities and was sorted by the size of the company’s capitalization. The smallest decile (smallest 10%) of these companies were further broken down into four groups of 2.5%.²⁰ Companies in the smallest quarter

²⁰ Ibid., p.4-10

(referred to as Decile 10z), represent the smallest 2.5% of the stock market in terms of their market capitalization.

Research has shown that as the size of a company's market capitalization decreases, its average rate of return tends to increase"²¹ However, if we plot a small company's return and volatility (beta) on the Security Market Line chart, we would find that small-cap stocks earn a higher level of return than would be suggested by the Security Market Line. That is, they fall above that line. (Note the four red dots on the above chart.) This additional return that is not explained by the Security Market Line is referred to as the Small Company Risk Premium. This premium is the portion of the rate of return that cannot be explained by the overall market beta and, therefore, is attributable to the small size of the company.

There are various methodologies used to calculate market beta. Duff and Phelps outlines three such methods – OLS Beta, Annual Beta, and Sum Beta.²² Duff and Phelps notes that the very smallest companies on the stock market (Decile 10z) generally trade infrequently. As a result, they exhibit more of a lagged price reaction relative to the overall stock market which exaggerates the beta calculation. Since our subject company is very small, we will be comparing it to the very smallest group of stocks on the stock market – Decile 10z. To avoid the distortion of the beta calculation as noted by Duff and Phelps, we used the Sum Beta methodology to calculate the Small Company Risk Premium.

Duff and Phelps - 2014 Valuation Handbook, Sum Beta Size Premiums-Pg 4-10

6.3.4 INDUSTRY RISK PREMIUM - 2.29%

When estimating the return on a small-cap stock, the above Small Company Risk Premium identifies the additional return that is attributable to just the company's size. At this point the assumption is that all the companies in this particular small-cap grouping bear the same level of systemic risk or beta as the overall market does (as depicted in the Equity Risk Premium section). This ignores the fact that regardless of size, companies in different industries bear different levels of systemic risk compared to the overall market as a whole.

For example we can look at two companies within the same industry, one a multi-billion dollar company that owns 10,000 gas stations and the second, a single-station family-owned operation. Regardless of size, both of these companies are exposed to the industry's unique risk. Thus an interruption in gasoline supplies would affect both companies. As such, it is not only appropriate to adjust the small company to reflect a size premium, but also adjust both companies to reflect specific industry risk.

Duff and Phelps has calculated the betas for hundreds of industries from which an Industry Risk Premium can be calculated. If the premium is positive, the industry bears a greater level of risk than the overall market beta would suggest and warrants a higher rate of return. If it is negative, the industry is at a lower level of risk than suggested by the overall market beta and would earn a lower rate of return. Throughout this report we have compared the Subject to a

²¹ Ibid., p.4-2

²² Ibid., p.4-9

composite of comparable companies, half of which were Office furniture manufacturers and half of which were Office furniture retailers. Companies classified under SIC Code #34 (Fabricated metal products) are shown to possess a higher degree of risk than the general market and therefore, a 2.29% risk adjustment should be *ADDED* to the Subject's expected rate of return.

Duff and Phelps - 2014 Handbook, Long-term Supply Side ERP for SIC = 34, p. 5-18

6.3.5 SPECIFIC COMPANY RISK PREMIUM – 5.00%

This is the last component of risk associated with equity investments. These risks are specific to the Appraisal Subject.

When comparing the Appraisal Subject with other potential investment opportunities, it should be noted that several of the specific premium amounts shown below are not, nor can they be, supported by academic research. The values cited should not be considered a precise measure of risk, but rather an indication of the Appraiser's judgment and experience with factors that affect value.

6.3.5.1 CONCENTRATION OF CUSTOMERS

As we have discussed throughout the report, nearly 90% of HiTech's revenues are derived from Google or other manufacturers who are supplying Google. This high-level concentration means that revenue volatility can very high and changes can occur very swiftly. HiTech has enjoyed a fourteen-year relationship with Google and sales have grown steadily during that period. Mr. Ho indicated that the relationship with Google is very good and prospects of future business are also very good. However, the computer and electronics industry is prone to rapid changes and even minor economic slowdowns can be wildly exaggerated at the downstream suppliers. These are systemic conditions that far outweigh good relationships.

A Specific Company Risk Premium of 5.00% is therefore added to the Subject's overall rate of return.

The total rate of return of 25.5% from the five paragraphs above (see Exhibit XIX) is that which an investor would demand on his equity portion of an investment in HiTech.

6.4 PERPETUAL GROWTH RATE AND THE CAPITALIZATION RATE

A key element in the formation of the Capitalization Rate is the Perpetual Growth Rate or the estimate of the long-term growth rate of the Subject Company in perpetuity. It is a common error to observe a few years' growth of a company and draw conclusions of its long-term growth potential. For example, the subject company may recently have shown annual growth rates in the 15% per year range. One might conclude that it could continue to grow at that rate. However, in order to maintain that rate in perpetuity means that the company would conceivably grow from \$5 million to \$330 million in thirty years and \$5.4 billion in fifty years. The appraiser's selection of a Perpetual Growth Rate must, therefore, be reasonable given that it is a lifetime growth rate.

Additional considerations were noted in the buildup exercise in Paragraph 6.3. The estimate for the rate of return on equity included the risk free rate of return and the return on stock market equities, both of which include gains due to inflation. Since these rates will be applied to the Subject's projected income stream to determine the value of the enterprise, we should, therefore, include inflation in the growth projections for our Subject. As such the forecast of earnings for HiTech and the Perpetual Growth Rate will be in current dollars, i.e. the nominal growth rate (real growth plus inflation).

From Section 2.5 we estimated that the Subject's long-term growth rate would be 5.0%. The capitalization rate used in the Income Approach is equal to the Rate of Return less the long-term growth rate.

The Capitalization Rate to be used in the Income Approach will be:

Rate of Return	25.5%
Perpetual Growth Rate	<u>-5.0%</u>
Capitalization Rate	20.5%

6.5 RECONCILIATION OF THE INCOME APPROACH

The capitalization rate is applied to following cash flow analysis developed in Exhibit XVII:

Exhibit XX Calculated Value from the Income Approach

<u>Normalized Cash Flow To Equity</u>		Para.	
From Exhibit XVII	Normalized Income after Taxes	1,221,978	6.2.5
	Plus: Depreciation	465,649	
	Increase (Decrease) in Interest Bearing Debt	26,645	6.2.5.3
	Less: Cash Outlays for Working Capital	(89,722)	6.2.5.1
	Less: Cash Outlays for Capital Expenditures	<u>(368,794)</u>	6.2.5.2
	Net Cash Flow to Equity-Current Year	1,255,756	
	Forecast Year with 5% Growth	<u>62,788</u>	6.2.5.4
	Projected Free Net Cash Flow to Equity	1,318,543	6.2.5.4
	Capitalization Rate	<u>÷ 20.5%</u>	
	Operating Value of Net Worth	<u>\$6,432,000</u>	

The above value of \$6,432,000 represents the *OPERATING VALUE* (i.e. exclusive of any non-operating assets and liabilities) of the net equity (i.e., the net worth) of HiTech Precision Sheetmetal, Inc. on a controlling, marketable basis. In the final reconciliation of value we will add back any *NON-OPERATING* assets that were initially removed from the Normalized Balance Sheet shown in Exhibit XV.

Our next step is to determine appropriate discounts, if any, for the Subject interest on a *controlling, non-marketable* basis. The discussion of potential Discounts for Lack of Control and Discounts for Lack of Marketability will follow the Market Approach in Paragraph 9.0.

7.0 MARKET APPROACH

As discussed in the Revenue Ruling 59-60, the valuation process should be a “forward looking” process.²³ That is, we are trying to look into the future potential of a company to determine its value today. The Market Approach, however, looks at actual transactions that are often years old and the financial data associated with the transaction obviously predates the sale. On the surface then, the Market Approach would appear to be looking backward in time.

The Market Approach, however, is a buyer-driven analysis. We are literally stepping back in time to the precise moment when a buyer and seller agreed to the terms of a sale. The buyer clearly made his decision to buy based on his assessment of the recent financial statements of the business, but just as importantly, the price he offered was based on his expectations of the future potential of the business. For example, a “dot.com” company in 2002 probably produced strong financials for 2001. However, the buyer’s expectations for the long-term future of this type of business would be very negative. The price he was willing to pay in 2002 would certainly reflect that expectation. Therefore, by comparing the selling price of the guideline business to its historical data, the resulting financial ratios describing that event clearly reflect the future long-term expectations of the buyer based on his knowledge of the current financial condition of the company. Thus in theory, by applying those same financial ratios to our Subject Company’s recent financial data, we would be calculating a price that a buyer would pay today that is based on the current financial condition of the company and a buyer’s future expectations.

The Market Approach includes a collection of methods which use actual transactional data from the marketplace. The following are various methods commonly used under this approach.

7.0.1 THE GUIDELINE PUBLIC COMPANY METHOD

The Guideline Public Company Method uses a database of publicly traded companies whose shares are freely traded. The method involves observing the stock prices and various ratios such as the Price/Earnings Ratio or Price/Book Value ratio of smaller publicly held companies in the same industry as the subject to determine appropriate pricing of the subject.

To apply this method properly, the selected guideline companies should be in the same industry and of similar size and relevancy to the subject. Relevancy is an important consideration; otherwise we might consider comparing the local hardware store to Home Depot. Raymond Miles, past director of the Institute of Business Appraisers, suggests that public companies are just not relevant at all when compared to privately held companies due to the significant differences in the size of the investor’s investment, the liquidity and overall risk of the investment, and the involvement of the investor in managing the company.

“Indeed it is possible to make detailed comparisons of each potential guideline company’s financial characteristics with the business being appraised. However, public companies in

²³ U.S. Internal Revenue Service, Revenue Ruling 59-60, (1959), Section 3, p.2, http://www.hantzmonwiebel.com/live_data/documents/ruling-59-60.pdf

general fall short in meeting the relevance requirement for guidelines to value small closely held businesses.”²⁴

As we will see throughout this report the size of a guideline company is an important factor in valuation. The appropriate parameters for the selection process in the Guideline Public Company Method have been advanced by Mr. Paul Hyde.²⁵

<u>Subject Company Revenue</u>	<u>Hyde’s Recommendation</u>
Under \$5 million	GPC method not applicable
\$5 to \$20 million	Comparables limited to five times revenue
\$20 to \$50 million	Comparables limited to ten times revenue
Over \$50 million	Comparables limited to 25 times revenue

Analysis: We agree with Mr. Miles’ assessment that public companies are not a relevant comparison with small privately held companies. Thus, the Guideline Public Company Method is unacceptable.

7.0.2 THE MERGERS AND ACQUISITIONS TRANSACTIONS METHOD

The Mergers and Acquisitions Transactions Method involves the acquisition of small publicly traded businesses by other larger public companies. The desired analysis of this database is to observe the prices of small publicly traded companies that are acquired by large public companies. Buyers in this arena are often what we refer to as “strategic, or investment buyers.” The synergies that exist between the acquiring and target companies are such that the acquiring company has far more to gain than just a return on investment. Strategic acquiring companies are often trying to dominate specific markets by buying up competitors, or trying to gain access to a specific market that fits with the markets they already control. These strategic transactions are often at a significant premium compared to those transactions where no specific synergy exists. Since the Standard of Fair Market Value followed in this report is to determine the transaction price between *any hypothetical buyers and any hypothetical sellers*, we must necessarily rule out those transactions where one specific player had a special agenda to fill; otherwise, we would have to do a different valuation for every different acquiring company.

Analysis: Therefore, the Mergers and Acquisitions Transaction Method is rejected.

7.0.3 THE DIRECT MARKET DATA METHOD

The Direct Market Data Method uses databases of smaller, closely held companies in which the controlling interest was sold. These transactions can typically be sorted by Standard Industry Classification (SIC), thus creating a statistically measurable “re-creation of the market.” The transactions in these databases, for the most part, were traded as Asset Sales or

²⁴ Raymond C. Miles, “*Technical Studies of the IBA Transactional Database*,” (Institute of Business Appraisers, Inc. 2003), part XXXIII, p 1.

²⁵ Paul R. Hyde, “*When Should the Public Company Guideline Method Be Used?*,” Business Appraisal Practice (Institute of Business Appraisers, Inc., Spring 2004), pp 2-5

sales that could easily be adjusted to reflect an Asset Sale. The characteristics of this method closely parallel that of the Subject Company.

Analysis: Therefore, the Direct Market Data Method will be the selected method used in the Market Approach.

The various sources of data contain transactions ranging from a few thousand dollars to over one billion dollars. The transactions are from businesses located all around the country which were consummated as recently as a few months ago to as long as twenty years ago. In addition, when searching a specific SIC group for transactions involving companies similar to the subject, we often find that some of these companies do not appear to be similar at all.

The selection of appropriate comparables (also referred to as “guideline or peer group companies”) from these databases will be made after careful consideration of the following:

7.1 NORMALIZED CASH FLOW

The discussion of the Market Approach will begin with the analysis of the Subject Company’s cash flow and normalized balance sheet and will be followed by a detailed description of the selection process used to obtain available data on comparables or guideline companies.

7.1.1 SELECTING THE BASE YEAR OF OPERATIONS

The Income Approach analyzes in depth the subject’s recent financial condition, makes detailed financial ratio comparisons to the guideline companies, and then, applies various assumptions and forecasts for the industry and economy to arrive at a projection of future earnings for the company. That earnings projection then forms the basis for the estimate of the subject’s value. The Market Approach, however, basically compares the guideline company financial ratios that were available at the time of its sale to the subject’s current financial ratios. However, if we focus just on the subject’s current financial statements, we are implying that it is a reasonable representation or proxy for the subject’s long-term financial potential. This may not always be the case. The subject company may have just enjoyed a record-breaking year or suffered unusual non-recurring losses. Thus, it might be inappropriate then to compare the subject’s current year with the average operating results of our selected sample of guideline companies.

To circumvent this possible distortion, it is not uncommon to see Market Value Multipliers applied to a subject’s earnings for the current year or an average, even a weighted average of the last several years’ earnings. Raymond Miles, author of *Technical Studies of the IBA Transaction Database*, even suggests that the multipliers should be applied to *projected* cash flow.²⁶ The Appraiser rejects this approach. The Market Value Multipliers obtained from the guideline companies were based on the selling price and the financial data that *was available at the time of the sale*. The guideline multipliers were not calculated on future earnings.

²⁶ Raymond C. Miles, *Technical Studies of the IBA Transaction Database*. (Plantation, Florida: The Institute of Business Appraisers, Inc., 2002), from “How to Use the IBA Market Database”, p. 4

However, as was noted earlier, the buyer tendered his price for a particular guideline company based on its recent financial data and his expectations of the future. Thus, the multipliers calculated from transactional data have an implied projected cash flow already built into the equation.

Gary Trugman provides us with various factors for determining the basis of Subject Company earnings to be used in the Market Approach.²⁷

- 1. If the company has cyclical earnings, the appraiser may want to use an arithmetic average of earnings.*
- 2. If the company is experiencing modest growth, the appraiser should consider a weighted average earnings, the latest 12 months earnings, or proforma earnings.*
- 3. Since the result of the valuation methodology is a “prophecy of the future,” caution must be exercised when using a weighted average, particularly when the company is growing. The results of the weighted average will rarely, if ever, reflect “probable future earnings.”*
- 4. If the company’s earnings are static it does not matter what earnings base is used as long as it is representative of the assignment at hand.*
- 5. If the company’s earnings are declining, the appraiser may want to consider a weighted average earnings, the latest 12 months earnings, or proforma earnings.*

The use of arithmetic averaging should be used only when overwhelming circumstances call for its use, such as in the case of item #1 above. The fact that a company’s revenues have been in decline for one or two years is, by itself, not a reason to use an average. It has been the Appraiser’s experience as a business broker that buyers will vehemently object to valuations based on higher revenues from previous years. They will clearly see it as an attempt to artificially increase the price of the business. Buyers absolutely refuse to pay for value that may have been present two or three years ago.

The valuation is as of December 31, 2014.

Analysis: As we noted in the Income Approach, the Subject’s revenue stream is subject to spikes due to the occasional large orders that it receives. The profitability of those large orders is also very volatile. It is reasonable to conclude that it will experience similar volatility in the future. As such, the average revenues and expenses for years 2010 to 2014 will be used as the normalized base of operations from which we will project future earnings.

Spreadsheets for the last six periods can be found on Exhibit XLII, Page 103.

²⁷ Gary R. Trugman, *Using the Market Approach to Value Small and Medium-Sized Businesses* (Orlando Florida: a paper presented at the Institute of Business Appraisers 1996 National Conference), p. 14

7.1.2 RECASTING SELLER'S DISCRETIONARY EARNINGS

Once the base year (or years) of earnings has been selected, the next step is to “recast” the financial statement. The “recasting” of a company’s earnings serves two purposes. First, since the databases we use for comparables are a collection of all forms of business entities, we need to strip away the differences in accounting methods used by those different entity types. For example, sole proprietorships (SP) report earnings on the Schedule C of the owner’s personal tax return. There is no owner’s salary expense in an SP; the “bottom line” represents his total income and payroll taxes for that income appears on his 1040. However, corporations and partnerships include a deduction for an owner’s salary expense including payroll taxes. Thus the bottom line for these entities is net of the owner’s salary and payroll taxes. Health benefits are a deduction in corporations but not in SP’s (benefits appear on the owner’s 1040). Donations are a deduction in C-corporations but not in S-corporations (donations appear on the owner’s K-1). Accelerated depreciation (IRC Section 179) and gains or losses from the sale of assets do not appear on an S-corporation tax return (they are on the owner’s K-1) but do on a C-corporation and on an SP. State income taxes do not appear on an SP but do on a Corporation. SPs by definition have one owner, whereas corporations and partnerships may have multiple owners all with salaries that are expensed, thereby reducing the bottom line. Finally, since interest expense can vary greatly between similar companies, making direct comparisons of earnings can be difficult. Thus, it is also common practice to remove interest expense from the recast financials.

In order to develop some measure of earnings for all these different entities that are directly comparable to each other, the databases have removed all those accounting differences from their income statements. Accordingly, each entity’s reported “earnings” is net of taxes, depreciation, health benefits, donations, capital gains, interest expense, and most importantly, net of just *one owner’s salary*.

If a company has multiple owners (including working spouses of owners), the salary of the one owner who would most likely be replaced by a hypothetical buyer is added back to discretionary earnings (SDE). It is also assumed that the hypothetical buyer would have to replace all the other owners with hired employees. As a result, if the replacement cost for those hired employees is less than the compensation paid to those other owners, the difference is also added back to SDE. Conversely, if the replacement cost for those hired employees is more than the compensation paid to those other owners, the difference is deducted from SDE.

In developing SDE, interest, depreciation, and income taxes are also *added back* to cash flow. After applying all the appropriate adjustments, then we can directly compare the recast discretionary earnings of corporations to sole proprietorships etc. The resulting Seller’s Discretionary Earnings (SDE) is the total cash flow a hypothetical owner has at his disposal for his salary and perquisites, his loan payments, and his capital expenditures. (*The terms “Seller’s Discretionary Earnings” and “Cash Flow” are used interchangeably in the following Market Approach discussion.*)

The second purpose for recasting a company’s earnings is to attempt to present a normalized view of the subject company’s operations. The recast financials should serve as a proxy for

Exhibit XXI Discretionary Cash Flow Analysis

Average of Last 5 Years	Dec 31, 2010 to 2014	Add Backs	See Para.
INCOME			
Sales	15,839,932	-	
Freight, Design	12,249	-	
TOTAL INCOME	15,852,181	-	7.1.3.1
COST OF GOODS SOLD			
TOTAL COST OF GOODS SOLD	9,752,178	-	
GROSS PROFIT	6,100,003		
	38.5%		
OTHER INCOME			
Expedite Charge	9,147	-	
NR Charge	9,086	-	
Other Income	26,369	-	
Gain (Loss) Sale of Assets	25,815	(25,815)	7.1.3.3
Purchase Discounts, Interest	7,455	-	
TOTAL OTHER INCOME	77,873	(25,815)	
EXPENSES			
Compensation to Owner	545,433	414,003	7.1.3.2
Payroll Expense	857,764	-	
Commission Expense	14,332	-	
Accrued Vacation	(4,426)	-	
Repairs and Maintenance	112,375	-	
Bad Debts	5,309	-	
Rent	635,614	635,614	7.1.3.3
Market Rent @\$5,000,000 Value	-	(345,215)	7.1.3.3
Executive Expenses	6,336	6,336	7.1.3.2
Payroll Taxes	394,381	16,560	7.1.3.2
Pension Contribution 401K	9,666	812	7.1.3.2
Advertising	2,998	-	
Donations, Gifts, Awards	5,431	5,431	7.1.3.4
Sales Tax	25,436	-	
State Income Taxes	960	960	7.1.3.4
Taxes, Licenses and Permits	5,183	-	
Depreciation, Amortization	421,107	421,107	7.1.3.4
Property Taxes	32,635	(34,365)	7.1.3.4
Interest Expense, Penalties	58,699	58,699	7.1.3.4
Outside Services	1,382	-	
Auto Expense	47,221	9,444	7.1.3.2
Bank and Credit Card Charges	5,818	-	
Insurance	27,842	-	
Health Insurance	323,498	9,856	7.1.3.2
Workman's Comp	210,451	-	
Professional Services	403,142	-	
Office Expense, Printing	44,957	-	
Sm Computer Equipment	18,717	-	
Misc., Dues, Training	10,525	-	
Operating Expense	15,740	-	
Company Event	8,087	-	
Travel and Entertainment	24,808	9,923	7.1.3.2
Employee Meals	13,322	-	
Supplies	43,397	-	
Freight & Shipping, Postage	339,747	-	
Expedite Fee (Moving Expense)	5,084	-	
Small Tool Expense	4,349	-	
Utilities	203,920	-	
TOTAL EXPENSES / Total Add-Ba	4,881,239	1,209,165	
TOTAL INCOME PER TAXES/P&Ls	1,296,636	-	
Total Add Backs =		1,183,349	7.1.3.5
SELLER'S DISCRETIONARY EARNINGS (SDE) =		2,479,985	15.6%

the level of operations from which we may reasonably expect future revenues to evolve. Thus we select an earnings period that best represents the current level of operations (which may not be the current year's P&Ls) and then we remove any non-operating income or expenses and any non-recurring income or expenses. The result should be an income stream for the subject company that we can reasonably expect under normal circumstances. The normalized P&L of the subject has now been properly recast and can be compared to the database guideline companies.

7.1.3 ADJUSTMENTS TO THE INCOME STATEMENT

7.1.3.1 VALUATION DATE

The value of the Subject was based on financial data available through December 31, 2014.

As discussed in Paragraph 7.1.1 above, the spreadsheet in Exhibit XXI shows average revenues and expenses for years 2010 to 2014 which will be used as the base-level of the Subject's earnings (See Page 103, Exhibit XLII for more detail). Just to the right of the P&L data are the "add-backs" that represent the normalizing adjustments necessary to reconcile earnings to Seller's Discretionary Earnings.

7.1.3.2 OWNER/MANAGER SALARIES

John Smith and Jane Smith are full-time managing owners of the company. Mr. Smith functions as the company's CEO and Jane Smith functions as its CFO.

Therefore, a hypothetical full-time managing owner/buyer for the company would essentially replace Mr. Smith and Jane Smith would have to be replaced with a salaried

employee. Consequently, the salaries and benefits of both owners will be added back to normalized earnings and the hypothetical replacement CFO's salary will be deducted.

Payscale, Inc., a national payroll data service, was used to estimate the market rate of the salary for a hypothetical CFO. The report can be found on Page 124. Payscale, Inc. indicated that a salaried CFO of a company this size would currently earn \$138,000. This amount was reduced by 2.5% per year for each of the preceding four years to account for wage inflation, producing a five-year average salary of \$131,430. John Smith and Jane Smith drew an average combined salary over the last five years of \$545,433. This amount is added back to cash flow and the average replacement salary for a CFO of \$131,430 is *DEDUCTED* for a net add back of \$414,003. In addition, the payroll taxes and company benefits associated with their salaries are also added back: payroll taxes are \$16,560, travel and meals benefits \$9,923, pension benefits \$812, auto benefits \$9,444, health insurance \$9,856, and miscellaneous executive expenses are \$6,336.

7.1.3.3 NORMALIZING ADJUSTMENTS

7.1.3.3.1 NORMALIZED RENT

The real estate from which HiTech operates is owned by another company that is wholly owned by Mr. Smith. Special circumstances arise in this situation that affect the value of a business. Mr. Smith estimated that the fair market value of the property is \$5,000,000. A hypothetical buyer of the business would finance the purchase of the property and the resulting debt service is estimated at \$345,215 per year. This amount is *DEDUCTED* from normalized cash flow and the actual rent paid to Mr. Smith's LLC is added back to cash flow. Detailed information on the calculation of the market value of rent can be found on Page 110, cell e43.

7.1.3.3.2 GAIN (LOSS) ON THE SALE OF ASSETS

Losses from the sale of assets of \$25,815 are non-recurring losses that are also non-operating in nature. Therefore, they are added back to normalized cash flow.

7.1.3.4 DEPRECIATION, INTEREST, AND TAXES

Seller's Discretionary Earnings (SDE) is calculated before interest expense, income taxes, depreciation, and donations. The company also takes advantage of a manufacturer's tax deduction referred to as Domestic Production Activities. This deduction is a non-cash charge and is treated the same as the depreciation deduction. Thus, for the Domestic Production Activities is added back to normalized cash flow.

7.1.3.5 CASH FLOW PROFIT MARGIN

The Subject Company's Discretionary Cash Flow Profit Margin (SDE%) for the normalized year is 15.6%. This margin of profitability is in between the mid and upper range earned by the guideline companies (12.5% to 18.4%, see Exhibit XXXV). *As we shall see in the discussion below on Market Value Multipliers, a company's Cash Flow Profit Margin (SDE%) is a major driver in determining its Fair Market Value.*

7.2 SELECTION OF APPROPRIATE GUIDELINE COMPANIES

Once the recasting of the Subject's P&Ls is complete, we can define our Subject in terms of its discretionary earnings, gross revenues, inventory, and FF&E. These four variables can now be directly compared to a sample of selected comparables.

The most commonly used databases in the Direct Market Data Method are Pratt's Stats, BIZCOMPS, BizBuySell, and the Institute of Business Appraisers (IBA). For the most part, the data from these sources is obtained from business brokers who represented the buyer or the seller in the transaction. IBA has the largest database of transactions, but information such as inventory, fixtures and equipment and discretionary earnings is often missing. As such it is difficult to reconcile the many complexities of each sale. Consequently it is the least useful database. BIZCOMPS reports the selling prices of a business excluding inventory. This database, however, does report the level of inventory separately; therefore, we simply add inventory to the BIZCOMPS' reported selling price in order to be comparable to the other two databases. BIZCOMPS reports 17 data points for each transaction and claims to carefully review the input to its database.

BIZCOMPS and IBA state that they calculate Seller's Discretionary Earnings slightly differently. (For example, IBA does not mention adding back depreciation into SDE.) However, this Appraiser has completed over 300 market-approach analyses and has made a point to carefully read the complete transaction reports of over ten thousand comparables from all three databases. In instances where both databases reported the same transaction, the Appraiser has found that in a high percentage of the cases the selling price, gross revenues, and discretionary earnings were identical. One can attribute this to the fact that the same broker will report a transaction to all three databases, and will submit only one calculation for Seller's Discretionary Earnings (SDE). Brokers will typically follow the convention recommended by the IBBA (International Business Brokers Association) for calculating SDE, a convention that BIZCOMPS expressly follows and one that IBA appears to accept by default. Therefore, all three databases will be considered similar enough in their respective construction to be grouped together.

Shannon Pratt draws the same conclusion in The Market Approach to Valuing Businesses:
*"One may combine the data from the three databases into a single table. [However,] the analyst must be aware of and make certain adjustments to reflect that the three databases do not define the underlying financial variables in exactly the same way."*²⁸

Pratt's Stats has over 65 data points for each transaction including a summary of the P&L and balance sheet, a description of the terms of the deal, the type of consideration tendered, and whether it is a stock sale or an asset sale. Because of the extensive information available, reconciling Seller's Discretionary Earnings or reconciling the actual selling price of the transaction is more reliable. Pratt's Stats calculates SDE the same way as BIZCOMPS and IBA; however, it is not uncommon to find discrepancies among all three. Careful analysis of

²⁸ Shannon Pratt, The Market Approach to Valuing Businesses, (John Wiley and Sons, Inc., 2001), p. 68

all three databases will help avoid selecting incorrect transactional data. The greater detail offered by the Pratt's Stats database can help reduce errors in selecting the transactional data. Therefore, if there are any discrepancies arising among duplicate transactions reported by the three databases, the Pratt's Stats data will generally be used in the analysis.

For an in depth discussion on how the above three databases are constructed and a listing of all the comparables used in this analysis, please go to the Appendix beginning on Page 116.

7.3 PROCEDURES USED IN THE DIRECT MARKET DATA METHOD

Once a sample of comparables that statistically represents the market has been selected, we can now apply various procedures to it that will ultimately determine the value of our Subject. The following are the four procedures that will be used in the Market Approach. Three are discussed below and the fourth, Multiple Regression Analysis, is discussed in section 7.5.2:

7.3.1 GROSS REVENUE MULTIPLIER – (Selling Price ÷ Gross Revenues)

This method is a simple ratio of a company's selling price divided by its gross revenues. Companies within a specific industry classification have a tendency to exhibit similar relationships between their revenues and selling price. Selling price and gross revenues of a company are readily obtainable, making this method easy to apply. However, it does not consider the company's profitability or asset valuation in the equation. Therefore, this method, if used by itself, may produce a misread of a company's potential value.

7.3.2 CASH FLOW MULTIPLIER – (Selling Price ÷ Discretionary Earnings)

This method is the ratio of a company's selling price divided by its Discretionary Earnings (SDE). It should be noted that the database sources used in the Direct Market Data Method calculate earnings differently than the way we calculated Net Cash Flow in the Income Approach. SDE is calculated by removing all owner's salaries and perquisites (such as health benefits, personal autos, etc.) from expenses. Interest, depreciation, income taxes, any one-time expense or income, and any non-operating expense or income are also removed from the income statement. The resulting Seller's Discretionary Earnings is that cash flow which the owner has at his disposal for his salary and perquisites, his loan payments, and his capital expenditures. (The terms "Seller's Discretionary Earnings" and "Cash Flow" are used interchangeably in the following Market Approach discussion.)

However, the same problem with the Gross Revenue Multiplier exists with the Cash Flow Multiplier. That is, the ratio only focuses on one aspect of the company's operations, its discretionary earnings. Therefore, if used by itself, this ratio may produce a misread of the company's value. For that reason the Market Approach typically includes both ratios to estimate the value of a business.

7.3.3 ENTERPRISE VALUE + INVENTORY – (Selling Price – Inventory ÷ Cash Flow)

Under certain circumstances, however, using the above two methodologies can still produce inaccurate results when valuing businesses that derive the bulk of their revenues from the sale of inventory. For example: it was determined that the average hardware store sells for .45 times its gross revenue and 3.30 times its SDE. In our search, we find two guideline companies, each doing \$900,000 in gross revenues and \$125,000 in SDE; yet one sold for \$400,000 and the second for \$600,000. The anomaly can probably be explained by the fact that the first store had \$200,000 in inventory while the second had \$400,000.

The Enterprise Value + Inventory methodology deducts the volatile inventory component from the selling price of the business. The difference is then divided by the company's SDE. The resulting ratio can be used to determine what is referred to as the Enterprise Value of the business; that is, the value of a business excluding its inventory. By using this methodology in the two above examples, we find that Enterprise Value for both businesses was 1.60 [Store #1 = $(\$400,000 - 200,000) \div \$125,000$; Store #2 = $(\$600,000 - 400,000) \div \$125,000$]. We can then use this ratio to estimate the value of a third hardware store which generated, say, \$1,450,000 in gross revenues, \$200,000 in SDE and had \$375,000 in inventory. Store #3's Enterprise Value is \$320,000 ($\$200,000 \times 1.60$); its total value including inventory is, therefore, $\$320,000 + \$375,000$, or \$695,000. The Cash Flow Multiplier by itself would have predicted only \$660,000 ($3.30 \times \$200,000$) and the Gross Revenue Multiplier would have predicted \$652,500 ($.45 \times \$1,450,000$). When reconciling these three Market Value Multipliers to estimate the value of this third hardware store, we might consider giving additional weighting to the Enterprise Value because this store primarily generates its revenue from the sale of Inventory.

7.4 FACTORS AFFECTING THE MULTIPLIERS

7.4.1 TIMING OF THE SALE

The transactions used for business valuations are often several years old. Most of us exposed to real estate appraisals on private residences have been told that proximity to the subject house and timing of the comparable's sale are critical to the valuation. Business valuations, however, are not calculated by looking at the actual selling price of the comparables. Instead, the subject company's financial ratios are compared with the ratios of the comparable businesses. As noted below, some of these financial ratios have a tendency to be fairly consistent over time. Secondly, small-business investors base their investment decisions primarily on a long-term view of the market. Unlike purchasing stock, where the holding period may be weeks or months, buyers of small businesses are often looking for career-length opportunities. Therefore, when comparing businesses that sold several years ago, the effects of recessions or bull markets on the revenue multiples of the business are somewhat minimized. Again, by using financial-ratio comparisons, the relationship between selling price and gross sales tends to be fairly stable over time. The time element that is so critical in real estate appraisals is not nearly as significant a factor in business appraisals.

The following research was discussed in the book by Gary Trugman, Understanding Business Valuation:²⁹

“Raymond C. Miles, C.B.A., A.S.A., executive director of the Institute of Business Appraisers, published a paper entitled, “In Defense of Stale Comparables,” in which Miles examined the almost 10,000 entries in the database, and demonstrated that most industries are unaffected by the date of the transaction when smaller businesses are involved. Miles performed a study that examined the multiples across various industries and time periods to see if, in fact, the multiples changed. The conclusion reached was that the multiples do not appear time-sensitive, since inflation affects not only the sales prices, but also the gross and net earnings of the business. Therefore, this information can be used to provide actual market data.”

More recently, similar results were cited by Jack Sanders, the creator of BIZCOMPS database.³⁰

“Recently, the author [Jack Sanders] compared current study data with the data over ten years old. First the Gross Sales to Selling Price ratio was compared. In the current National Database that ratio was available in 6,748 out of 6,851 transactions. The arithmetic mean of this ratio was .46, while the median was .38. A similar analysis of 879 transactions out of 954 transactions older than ten years was made.

The arithmetic mean was .44 and the median was .37. The same analysis was made of the Seller’s Discretionary Earnings (SDE) to Selling Price ratio. The arithmetic mean for the current study was 1.95 while the median was 1.8. In the over 10 year-old data, the arithmetic mean was 2.0 and the median was 1.8.”

Recently, there have been some concerns raised within the appraisal community that the recession has produced a significant amount of volatility in transactional multipliers during the last five to seven years which may skew one’s results when employing the market approach³¹. To test that theory I assembled a sample of transactions obtained from the Pratt’s Stats database. The sample was filtered for all transactions between 1999 through 2013 with revenues under \$2 million. Stock sale transactions were eliminated, as were companies with breakeven or negative cash flow.

The Revenue Multipliers and Cash Flow Multipliers were calculated from each transaction’s revenues, seller’s discretionary earnings (SDE, or cash flow), and selling price. The data was sorted by the year in which the sale took place and the resulting median value of the multipliers from each year was determined. The resulting sample of 9,723 transactions is listed on the table in Exhibit XXII.

²⁹ Gary Trugman, Understanding Business Valuations: A Practical Guide to Valuing Small to Medium Sized Businesses. (New York: American Institute of Certified Public Accountants, 1988), p. 150

³⁰ Jack Sanders, “BIZCOMPS User Guide,” (Las Vegas, NV, 2004), p. 7

³¹ Toby Tatum, Analysis of Bizcomps Database: Past and Present, Business Appraisal Practice-Qtr IV, 2013, p. 19

As we expected from our initial discussion of the effects of time on multipliers we find that the Revenue Multipliers have been relatively stable over time. From the top table in Exhibit

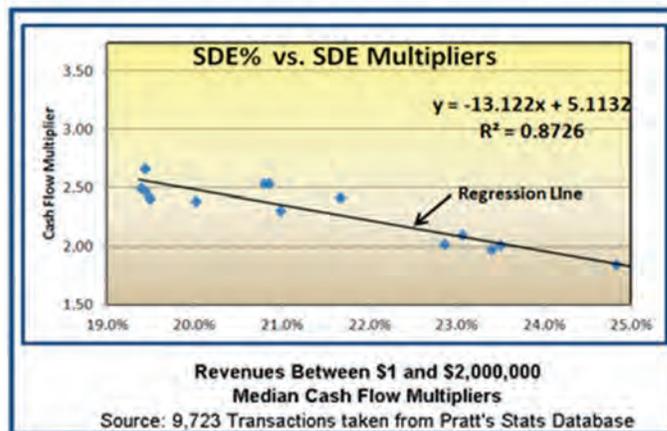
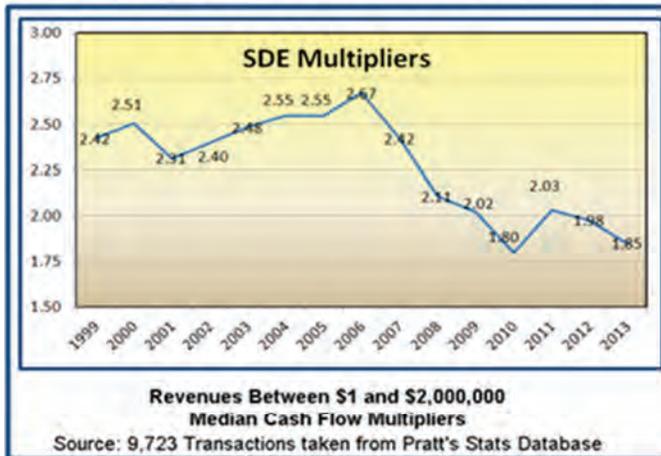
Exhibit XXII Transactional Multipliers over the Last Fifteen Years

Date Range		Count	Median Revenue Multipliers	Median Cash Flow Multipliers	Median SDE% (SDE/Rev)
From	To				
1-1-1999	12-31-1999	319	0.470	2.422	19.5%
1-1-2000	12-31-2000	297	0.479	2.505	19.4%
1-1-2001	12-31-2001	389	0.461	2.315	21.0%
1-1-2002	12-31-2002	502	0.468	2.397	20.0%
1-1-2003	12-31-2003	473	0.466	2.484	19.4%
1-1-2004	12-31-2004	625	0.489	2.547	20.8%
1-1-2005	12-31-2005	688	0.484	2.549	20.8%
1-1-2006	12-31-2006	679	0.500	2.673	19.4%
1-1-2007	12-31-2007	765	0.498	2.423	21.7%
1-1-2008	12-31-2008	1088	0.473	2.107	23.0%
1-1-2009	12-31-2009	758	0.466	2.024	23.5%
1-1-2010	12-31-2010	858	0.455	1.799	25.1%
1-1-2011	12-31-2011	782	0.473	2.032	22.8%
1-1-2012	12-31-2012	801	0.441	1.979	23.4%
1-1-2013	12-31-2013	250	0.458	1.851	24.8%
Average			0.472	2.274	21.6%
Lower Quartile			0.463	2.03	19.7%
Upper quartile			0.482	2.49	23.2%

Source: 9,723 Transactions taken from Pratt's Stats Database

XXII we observe that the average Revenue Multiplier over the last fifteen years was .472. The lower quartile was .463 and the upper quartile was .482. Thus, Revenue Multipliers fluctuate within a very narrow range from year to year and using comparables that are several years old should not inappropriately skew our results.

Cash Flow Multipliers, however, have fluctuated significantly over the years. The middle chart in Exhibit XXII is a visual presentation of the data from the table. The graph clearly shows that Cash Flow Multipliers (SDE) have declined significantly since the start of the recession. One's initial reaction is that appraisers should only use multipliers exhibited during the most recent years to account for this attrition. An alternative would be to create an index that reflects the current level of the multiplier with respect to its long-term average. The index would then be applied to the Subject's calculated multiplier to adjust it to the current trend. A third alternative involves the use of regression analysis which will allow us to use transactions over the last fifteen years regardless of the level of multipliers any one year.



As we will discuss in much greater detail in section 6.5 below, there is a moderate correlation between a company's Cash Flow Multiplier and its operating profit margin. (The operating profit margin (SDE%) is calculated by dividing a company's SDE (cash flow) by its total revenues.) By using regression analysis we can plot the above sample's median SDE% values against the corresponding Cash Flow Multipliers for each year. The

lower chart in Exhibit XXII gives a visual presentation of the resulting regression analysis.

The regression line shows that the level of a company's profitability, as measured by SDE%, closely tracks its Cash Flow Multiplier. This fact is underscored by the regression analysis' very high R squared factor of 0.872. *An R squared of 1.0 would mean there is a perfect correlation between Cash Flow Multipliers and SDE% whereas an R squared of 0.0 would mean there is no correlation.*

The regression analysis also gives us a formula for the regression line which can be used to predict the median multiplier in any given year regardless of whether it is a recession year or a boom year. For example, from the top table on the preceding page we find that the median SDE% for the recession year 2010 was 25.1%. From the bottom chart, the regression formula of $y = -13.12x + 5.11$ can solve for the 2010 multiplier by inputting the year's SDE%: $y = -13.12 \times .251 + 5.11 = 1.82$, the predicted Cash Flow Multiplier for 2010. The actual multiplier for that year was a very close 1.799. The multiplier for the boom year 2006 is also predicted using that year's SDE% of 19.4%: $y = -13.12 \times .194 + 5.11 = 2.56$. Again, by using SDE%, the predicted Cash Flow Multiplier for the boom year of 2006 was very close to the actual value of 2.673.

Analysis: The search criteria used by the Appraiser when selecting guideline companies from the various databases, therefore, will not exclude transactions based on the timing of the sale and each comparable's SDE% will be used to estimate the Subject's Cash Flow Multiplier.

7.4.2 LOCATION

The location of a business can certainly have a significant impact on its value. For example, we often hear comments from business owners such as, "my restaurant has the best location in town and, therefore, deserves a much higher valuation." That observation would be true if that business were more profitable than its competitor. When applying the *same* Cash Flow Multiplier to the two different locations, the restaurant with the higher profits (and superior location) would earn a higher calculated value than the other. The superior location undoubtedly contributed to the company's higher profitability, and hence, its higher value. If the company at the supposed superior location generated the same level of profits as its competitor, one would have to seriously question the contention that the location is superior.

Selecting guideline companies from different states for comparison with the subject frequently raises challenges. The Appraiser researched the BIZCOMPS database to determine if there were compelling differences in the Market Value Multiples earned by companies from different states. The exhibit below shows the Cash Flow Margins (SDE%) and Revenue and Cash Flow Multiples of companies sold in the major states throughout the country.

Tests were performed on the database to determine if various economic factors influenced the level of Market Value Multipliers earned by companies throughout the country. A regression analysis was performed comparing the population growth rate of a given state with the Gross Revenue Multiples earned by companies within that state. The hypothesis here is that high-growth areas must assuredly attract business buyers who are willing to pay a premium for

access to that market. The regression produced an R-Squared of 0.30. The value, although not compelling, suggests that there is a modest tendency for high-growth areas to produce higher Gross Revenue Multiples than low-growth areas. (An R-Squared of 1.0 means a perfect correlation between variables, whereas 0.0 means no correlation at all.) The table below was sorted by states with the lowest population growth on top and the highest population growth on the bottom. We can visually see that states with the lowest population growth typically have lower Median Revenue Multiples.

A second test was run comparing the growth rate of household income within a state with the Gross Revenue Multiples earned by companies sold in that state. The percentage change in median household income from 2000 to 2007 for each state was regressed against the median Gross Revenue Multiples earned by companies sold in that state. The hypothesis here is that communities enjoying surging income levels will attract buyers of businesses who perceive investment opportunities. The regression only produced an R-Squared of 0.0006; i.e., there was virtually no correlation between rising incomes and the Gross Revenue Multiples earned in a given region. Therefore, that hypothesis is rejected.

However, a multiple regression analysis was performed combining the population growth rate and the income growth rate of a region and comparing them with the Gross Revenue Multiples. The combination produced an R-Squared of 0.35. The value suggests that communities enjoying higher population growth and a higher growth in household income may produce transactions with higher Market Value Multiples.

Exhibit XXIII Market Value Multiples by Different States

State	Median Revenue	Median Cash Flow Margin	Median SDE Multiplier	Median Revenue Multiplier	Population Growth	Income Growth	# of Sales
OH	703,000	13.6%	2.22	0.31	1.0%	17.3%	58
PA	497,000	18.8%	2.31	0.42	1.2%	25.3%	44
MA	650,000	17.4%	2.33	0.37	1.5%	28.1%	139
WA	465,000	14.1%	2.49	0.36	1.7%	25.0%	58
IA	538,000	17.2%	2.25	0.33	2.0%	23.1%	43
NC	695,000	15.8%	2.46	0.36	3.3%	20.2%	81
UT	354,000	21.0%	2.17	0.49	4.0%	23.5%	95
MN	500,000	12.6%	3.57	0.49	5.7%	22.7%	124
CA	600,000	18.2%	2.33	0.40	7.9%	28.8%	911
ID	577,000	16.0%	2.57	0.39	9.8%	26.0%	150
CO	703,000	18.0%	2.42	0.43	13.0%	19.9%	472
FL	586,000	21.7%	2.01	0.42	14.2%	17.2%	2617
TX	580,000	19.9%	2.08	0.40	14.6%	22.9%	335
GA	742,000	18.8%	2.34	0.43	16.7%	19.1%	424
AZ	535,000	22.2%	2.34	0.50	23.5%	26.1%	436
Median		18.0%	2.33	0.40			2,237
Average		17.7%	2.39	0.41	* 7.0%	* 24.2%	
Standard Deviation		2.9%	0.358	0.056	(* Total US Growth Rates)		
Coefficient of Variation		0.163	0.150	0.138			
Comparables were selected from BIZCOMPS Database of 10,065 transactions.							
Transactions of \$250,000 and higher were selected							
Only states with more than 40 transactions were included in the analysis.							
Population growth is the annual growth rate of the state from 2000 to 2007.							

For example, from Exhibit XXIII below we can see that the population growth and growth in household income for California are about at the median level of other states. The research would then suggest that California businesses should also sell at Gross Revenue and Cash Flow Multiples that are near the median values found in other states, and in fact, the data bears this out. Both the Gross Revenue Multiples and Cash Flow Multiples of companies sold in California were exactly equal to the median values found in all major states.

Given that population growth may have a positive effect on the Gross Revenue Multiples at the state level, we can draw the

conclusion that high-growth communities within the state should also enjoy higher multiples than low-growth communities earn. Therefore, this report will research the growth rates of the community or market area that the Subject serves and compare it to the growth rate of the entire state or country.

Analysis: The search criteria used for selecting comparables from the various databases, therefore, will include all transactions regardless of their location. However, an adjustment to the Gross Revenue Multiplier will be made if the community or region that the subject serves has a population growth rate and income growth that is significantly above or below the median for the whole state.

7.4.3 SIMILARITY OF COMPARABLES: THE PRINCIPLE OF SUBSTITUTION

*“The theory of the Market Approach to valuation is the economic principle of substitution: One would not pay more than one would have to pay for an equally desirable alternative.”*³² The operative words “equally desirable or similar” often create debate. A business owner is quick to point out the many unique characteristics of his company that make it distinctive in the marketplace and, therefore, should add to its value. The owner’s customers will make those same distinctions, which is why they patronize the owner’s business. A buyer, however, typically does not make those distinctions. For the most part, a buyer of a small business is buying a job, a job that must support the lifestyle to which he is accustomed. We have actually seen a buyer submit an offer on a grocery store, but then subsequently buy an X-ray equipment servicing business instead. The reason he did not buy the grocery store was not because it did not have eight-foot high gondolas, or was not affiliated with the right franchisor, but rather, the X-ray equipment company simply just made more money. Clearly, a buyer’s search criteria are just not detail oriented.

As was previously mentioned, the Market Approach is a buyer-driven analysis. Thus in searching for comparable sales, it is not essential that the comparable be an exact match to the subject company. The ease with which buyers choose between different types of businesses means that fairly broad classifications of businesses tend to exhibit similar value characteristics. The buyer will simply not pay more for a business when there is an equally desirable substitute offered at a lower price.

Analysis: The search for comparables will begin by searching for transactions by Standard Industrial Classification (SIC) groupings. This is a table of business classifications produced by the U.S. Department of Labor’s OSHA division in which all similar businesses are grouped into one of more than 2,000 separate categories.³³

7.4.4 SIZE OF THE COMPANY

The size of a company, in terms of its gross revenues, has a direct bearing on its value.

³² Shannon P.Pratt, The Market Approach to Valuing Businesses, (New, York, John Wiley & Sons, Inc.), p.xxxiv

³³ U.S. Department of Labor- OSHA Division, <http://www.osha.gov/pls/imis/sicsearch.html>

The Pratt's Stats database of over 11,500 transactions was sorted by company size. The results below show that, with few exceptions, smaller companies earn lower Cash Flow Multipliers (also referred to as SDE Multipliers in the report) and Gross Revenue Multiples than larger ones. For example, all companies in the table below generated a median SDE Multiplier of 2.36, whereas, those companies with revenues under \$500,000 earned only 2.03. Thus the smallest companies earned multiples of $2.03 \div 2.36$ or 86% of what the average sized companies earned when sold. Similarly, companies with revenues between \$1,000,000 and \$2,000,000 exhibited a median SDE Multiplier of 2.67 which was 13.1% higher than the average sized company.

Exhibit XXIV Market Value Multipliers by Size of Company

Total Transactions	Total Sales		SDE Multiplier			Revenue Multiplier		
	Sales Range	Median Sales	Lower Quartile	Median	Upper Quartile	Lower Quartile	Median	Upper Quartile
6,595	\$0-\$500,000	249,553	1.33	2.03	3.13	0.33	0.50	0.76
2,550	\$500,000-\$1,000,000	709,393	1.62	2.40	3.55	0.28	0.43	0.64
1,612	\$1,000,001-\$2,000,000	1,396,038	1.76	2.67	3.82	0.25	0.41	0.64
951	\$2,000,001-\$5,000,000	3,024,720	1.86	2.96	4.45	0.22	0.41	0.68
232	\$5,000,001-\$8,000,000	6,374,250	2.56	3.83	5.53	0.23	0.46	0.87
347	\$8,000,001-\$25,000,000	14,001,504	3.09	4.61	6.86	0.33	0.58	1.11
250	\$25,000,001-\$100,000,000	50,539,984	3.78	5.80	8.06	0.38	0.74	1.20
Overall Totals								
12,537	All Transactions	800,000	1.51	2.36	3.71	0.30	0.47	0.72
Coefficient of Variation of Whole Database =				68.2%				84.1%
Pratts Stats Database contained a total of 22,304 transactions on 1-26-15								
The following transactions were eliminated from the above analysis to avoid potential ratio distortions:								
1) Corporate Stock Sales			3) Companies with negative cash flow					
2) Assets Sales where liabilities were assumed.			4) Companies with Cash Flow Multipliers over 10.0					

The Subject Company's gross revenues during the years observed were as high as \$16,601,655.

Analysis: The size criteria used to select guideline companies were those businesses whose revenues fell roughly in the \$3,000,000 to \$30,000,000 range. Often it is difficult to find enough comparables within a given revenue range similar to the Subject. Therefore, in order to get a sample of reasonable size, it may be necessary to select somewhat larger or smaller guideline companies. In this case it is important that the average revenue size of the whole sample be fairly close to the subject's revenue history. The selected range of revenues that were used in the sample was \$3,000,000 to \$30,000,000.

7.4.5 OTHER FILTERING CRITERIA

The last filter criteria applied to the remaining database was to eliminate any transaction with negative or near zero earnings. Companies with earnings that are negative or near zero will produce SDE Multipliers that are negative or extraordinarily high, causing averages and standard deviations to be skewed inappropriately. By way of example: selling price = \$400,000, revenues = \$1,000,000, and SDE = \$25,000. The resulting SDE Multiplier = 16 ($\$400,000 \div \$25,000$). One would normally draw the conclusion from a SDE Multiplier of 16

that the company sold for an extraordinarily high price. In this case, it was just the result of a very small denominator – Cash Flow.

Of the 6,279 transactions matching the initial search criteria in the Pratt's Stats database, 843 were found to have SDE Multipliers that were greater than 10.0 or less than zero. The median Discretionary Earnings Profit Margin (SDE%) ($SDE \div \text{Total Revenue}$) for this group was only 4.4%, whereas, the median for the entire Pratt's Stats database was 19.3%. Thus companies with SDE Multipliers greater than ten are more than likely to be unprofitable companies. Since discretionary earnings are the denominators in the SDE Multiplier equations, the high multiples earned for this group are clearly a function of a very low earnings level rather than a high price level. In addition, this group also yielded a very high Coefficient of Variation of 127.2%. The 843 transactions in this group are, therefore, loaded with outliers with distorted multiples.

Analysis: In selecting companies that are comparable to the Subject, those that are unprofitable are not relevant comparisons. The Subject Company is a profitable one; consequently we should compare it to other profitable companies. Therefore, companies with SDE Multipliers that are negative or greater than ten will be rejected from the analysis.

7.5 STATISTICAL ANALYSIS OF THE SAMPLE

7.5.1 COEFFICIENT OF VARIATION

After taking into consideration the filters described in the above six paragraphs, we may find that the sample of comparables that we have selected may be as few as ten to twenty-five transactions. The risk in using a smaller sample of comparables is that one or more “outlying” comparables can significantly distort the ratio analysis of the entire sample. By “outlying” we mean that the Market Value Multipliers produced by the single guideline company are so far above or below the other observations that it caused the group's overall averages to be skewed. Thus when trying to measure where the market is, it is accepted practice to use the median of a sample rather than its average. The average of a sample will be affected more by a single outlier than the median. Regardless, both measures are at risk of sampling error due to small sample size. For that reason, standard deviation and coefficient of variation tests will be run on the sample which will then be compared to the entire Pratt's Stats database of 11,500 companies.

Standard deviation is a statistical tool that measures the spread between the multipliers of each individual comparable and the corresponding average for the entire sample of comparables. In other words, the standard deviation measures the degree of variability or dispersion within a sample. However, when comparing our small selection of comparables to the entire Pratt's Stats database, the standard deviations of the two samples, by itself, does not tell us which sample is more accurate. For that determination we use the coefficient of variation (CV). CV equals the standard deviation of the sample divided by its average. The degree of dispersion within the sample is measured as a percentage of that sample's average. For example, if a sample's average Cash Flow Multiplier was 5.0 and its standard deviation was 1.5, statistically speaking, approximately 16% of all comparables would have a multiplier above 6.5 ($5.0 + 1.5$), and 16% would have a multiplier below 3.5 ($5.0 - 1.5$). The CV would indicate that the

remaining 68% of the observations has a multiplier that is within plus or minus 30% of the average ($1.5 \div 5.0$). Thus the coefficient gives us a tool that measures how tightly packed around the average that the majority of (.i.e. 68%) the comparables in a sample are. A sample where the majority of the comparables are within plus or minus 20% of the average is a much more meaningful sample than one in which the majority is within plus or minus 40% of the average. If one sample has a much lower CV than the second, we can assume that the second sample has one or two outlying observations that may be distorting its overall average and, thereby, giving us a false read of the market.

The best way of defining CV is through an example. Sample #1 in Exhibit XXV contains the Cash Flow Multipliers of six sales transactions. The sample's median is 4.5 and its average is 4.6. Sample #2 also contains the Cash Flow Multipliers of six transactions. This sample has an average of 4.6, the same that was found in Sample #1. However, the median was a moderately lower 4.0.

Exhibit XXV Example Coefficient of Variation

Cash Flow Multipliers		
	Sample #1	Sample #2
Transaction #1	4.6	7.7
#2	4.0	2.0
#3	4.4	3.0
#4	4.7	9.0
#5	5.7	1.0
#6	4.0	5.0
Median	4.5	4.0
Average	4.6	4.6
Stand Deviation	0.63	3.2

In choosing which sample is a more accurate measure of the market, we could simply look at the six observations in Sample #1, and intuitively we know that 4.5 is a good guess of where that market is. When looking at Sample #2, we have no clue as to what a good guess would be. Sample #2's observations appear to be randomly scattered and any guess may be way off the mark. The CVs for these two samples statistically tell us what we already detected from visual inspection. The CV for Sample #1 was only 14%, whereas #2 was 63%.

Given the choice between the two samples, Sample #1 produces, by far, a better indication of where the market is as evidenced by its much lower CV value.

As noted by Shannon Pratt, "*All else being equal, multiples [derived from a sample database] exhibiting low Coefficients of Variation tend to more accurately reflect market consensus with respect to value.*"³⁴ Mr. Pratt also notes, "*When Market Value Multiples among companies are tightly clustered, this suggests that these are the multiples that the market pays most attention to in pricing companies ... in that industry.*"³⁵

Three different Market Value Multipliers will be used in this report. Standard deviations and CV's will be calculated for each sample which will then be compared to the entire Pratt's Stats database of 11,501 transactions. If either sample produces significantly higher coefficients, we will reduce its weighting, or eliminate it altogether when reconciling all the calculated values to obtain a single value conclusion.

³⁴ Shannon Pratt, *The Market Approach to Valuing Businesses*, (John Wiley and Sons, Inc., 2001), p. 212

³⁵ *Ibid.*, p. 133

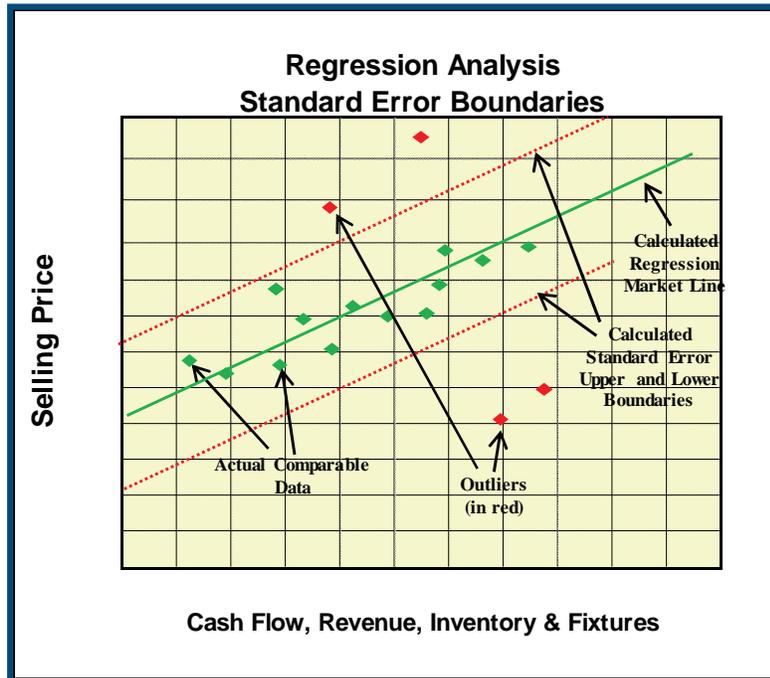
7.5.2 REGRESSION ANALYSIS

The next phase in the process of selecting a suitable sample of comparables is to attempt to identify individual observations within that sample that might be so far out of alignment with the rest of the sample that it is distorting our view of where the market is.

Regression analysis is a statistical tool that we will use that compares various key characteristics of each guideline company (gross revenues, SDE, inventory, FF&E, and SDE%) with its selling price. If each of these key characteristics is plotted on a graph, the regression calculation produces a line that will be the "best fit" between those points versus the selling prices. The regression line, referred to as the Market Line, therefore, is the measurement representing the closest relationship between these key variables and the selling prices of all the observed companies in the sample.

Those guideline companies whose actual selling price is radically different from the price indicated by the Market Line (i.e. they are significantly out of alignment with the rest of the market) can now be easily identified. The regression analysis not only plots a line that best represents where the market is, but also calculates what is referred to as standard error lines. The standard error is a statistical measurement similar to standard deviation in that it calculates the upper and lower boundaries between which most of the comparables should theoretically fall. Those comparables that fall outside these boundaries are companies whose selling prices were so far above or below the rest of the market that their transactional data must be considered flawed. These "outliers," as they are referred to, will be removed from our sample of comparables.

Exhibit XXVI Outliers Identified by Standard Error



The example in Exhibit XXVI graphed the points of 17 comparables on a chart (13 green and 4 red). The regression analysis calculated a Market Line (in green) that is the closest fit to all those points. The regression also calculated a standard error which indicates theoretical boundaries (in red) in which approximately 16% of all companies should fall above the upper boundary line and 16% should fall below the lower boundary line. Four observations (in red) fell outside these boundaries and, therefore, are not considered representative of the market. The observations that fall outside the standard error boundaries will be considered outliers.

After the outliers have been removed from our initial sample of comparables, we end up with a sample that is even smaller. As noted above, smaller samples carry a greater risk that one or two observations may still skew the results and present a false read of the market. Therefore, we will apply the CV test described in Paragraph 7.5.1 above to the second, smaller sample. If the new smaller sample produces CV ratios that are lower than those observed in the original sample, we will conclude that the smaller sample is a more accurate read of the market.

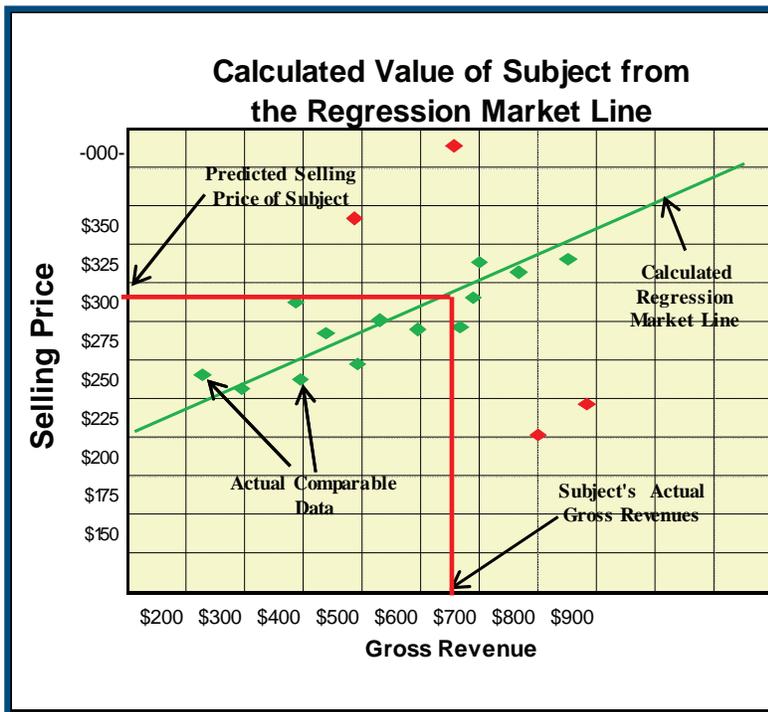
7.5.3 FOUR REGRESSION CALCULATIONS TO BE USED

We have discussed above how regression analysis helped us identify outliers within our initial sample of comparables. The resulting smaller sample has now been statistically cleaned up and, therefore, should give us a more accurate read of the market. As was also noted, the regression analysis produces a formula from which a line can be graphed that best represents that specific market. By plotting our Subject’s actual variables on the chart, the Market Line will then enable us to determine the probable value of the Subject Company.

REGRESSION #1 – MULTIPLE VARIABLE REGRESSION

Our Market Approach will employ four different regression calculations. The first is referred to as a Multiple Variable Regression Analysis. This statistical tool simultaneously compares four key variables of each comparable (gross revenues, SDE, inventory, and FF&E) with its respective selling price. The regression produces a formula, then, from which we can input our subject’s four actual variables and calculate its probable selling price. For demonstration

Exhibit XXVII Example Regression Analysis



purposes a simplified regression analysis is graphed in Exhibit XXVII . The values for the selling price and the gross revenues of 17 comparables were plotted on the chart and a regression line was then calculated. The subject company’s gross revenues of \$700,000 is then located on the horizontal X-axis. By moving vertically from that point to the regression Market Line we can then identify the probable selling price of \$300,000 from the vertical Y-axis on the left side of the chart.

The chart in Exhibit XXVII is a *single variable* regression analysis that regressed revenues against the selling price. A *four variable* multiple regression is literally four of these charts layered one on top

of the other with each layer representing one of the four variables. The calculated Market Line then cuts through all four layers. The multiple regression formula is actually several pages long. However, an Excel Spreadsheet can perform a multiple regression analysis with a few clicks of a button.

REGRESSIONS #2 TO 4 – SINGLE VARIABLE REGRESSIONS

The remaining three regression calculations to be used in this report will compare the discretionary earnings profit margin (SDE%) of the comparables against their respective Cash Flow Multipliers, Revenue Multipliers, and Enterprise Multipliers. These three tests are discussed in greater detail below.

Each of the four regression tests to be used in the analysis will produce an R-Squared factor which measures how closely all the comparables fit to their respective Market Lines. An R-Squared of 0.0 means that the calculated Market Line had no predictive value whatsoever. An R-Squared of 1.0 means that the Market Line exactly predicted the selling price for each of the comparables. Thus R-Squared gives us a means to compare how good each regression was at predicting the Subject's value in much the same manner as the CV ratio did in the sampling tests done earlier in the report. Thus in the final reconciliation at the end of this report, the predicted selling prices calculated by each of the four regression tests will be weighted using their respective R-Squared factors as guidelines.

7.5.4 DISCRETIONARY EARNINGS PROFIT MARGIN (SDE%) – $(SDE \div \text{Revenues})$

IRS Ruling 59-60 instructs business appraisers to give considerable weighting to a company's profitability when determining its value.³⁶ As such we observe the subject's cash flow growth over the previous several years and identify all the drivers that created that growth. We also look at the subject's local market and how it will affect its operations and consider the prospects for its continued growth in the future. We then compared the subject's balance sheet and P&L ratios to a database of thousands of similar companies to determine the subject's relative strength compared to its peer group. *The question is, then, once we have determined that our subject is better than its peer group, what is the market willing to pay for that?*

When trying to make a direct comparison of the subject to companies that have recently sold, the available databases of sold comparables do not provide us with much financial information. The only effective tool available is to compare each company's discretionary earnings profit margins (SDE%). This simple ratio, discretionary earnings divided by gross revenues, gives us the means to directly compare the relative performance of companies in terms of their profitability and how it affects the selling price of the business. Generally speaking, when comparing companies of similar size and SIC classification, those which have higher SDE% tend to be the more dominant players within their markets. They can command higher prices for their products and services, and they control expenses more efficiently than their competition.

³⁶ Internal Revenue Service, Revenue Ruling 59-60, 1959, http://www.hantzmonwiebel.com/live_data/documents/ruling-59-60.pdf, section 5, p.5

Since this one measure of a company’s profitability will be used extensively in the following Market Approach, it is important to understand all the subtleties behind it.

7.5.4.1 SIZE OF COMPANY VS. ITS DISCRETIONARY EARNINGS PROFIT MARGIN (SDE%)

First, from Exhibit XXVIII we can see that *the larger the company is, the lower its SDE%*. This appears to be a direct contradiction to what we observed in the previous section above, i.e., the larger the company the higher its Cash Flow Multiplier. This apparent anomaly can be explained as follows:

Exhibit XXVIII Discretionary Earnings Profit Margin by Size of Company

Total Transactions	Sales Range	Median Cash Flow Profit Margin (SDE%)
6,595	\$0-\$500,000	25.4%
2550	\$500,000-\$1,000,000	18.3%
1612	\$1,000,001-\$2,000,000	15.4%
951	\$2,000,001-\$5,000,000	14.1%
232	\$5,000,001-\$8,000,000	12.4%
347	\$8,000,001-\$25,000,000	13.6%
250	\$25,000,001-\$100,000,000	12.1%
Overall Totals		
12537	All Transactions	23.6%

The following transactions were eliminated from the above analysis to avoid potential distortions:

- 1) Corporate Stock Sales
- 2) Asset Sales where liabilities were assumed
- 3) Companies with negative cash flow
- 4) Companies with Cash Flow Multipliers over 10.0

Pratt's Stats Database of 22,304 transactions, 1-26-2015

In smaller companies under \$500,000 in revenue, the owner typically manages all facets of the entire business by himself. He is the salesman, marketing manager, HR manager, and bookkeeper. All the profits flow to the owner to compensate him for all these jobs. As we see from Exhibit XXVIII, companies that size generate cash flow at an average of 25.3% of every dollar of revenue. For a \$500,000 company, then, that would translate to \$126,500 in Discretionary Earnings. From Exhibit XXIV we saw that a \$500,000 company would sell for 2.05 times its earnings, which in our example would be \$259,325.

For this company to grow to \$2 million, however, the owner must now hire a bookkeeper, an HR manager, and possibly a CFO. The company is now too big for the

owner to do everything himself. A \$2 million company typically earns \$312,000 in discretionary earnings (\$2 million x 15.6% [from Exhibit XXVIII]). Thus when a company grows from \$500,000 to \$2 million, the additional \$1.5 million in sales added \$185,500 in earnings which only yields an SDE% of 12.4% (\$185,500 ÷ \$1,500,000).

Thus the \$2 million company in the above example produced higher levels of gross revenues and discretionary earnings yet earned a lower SDE%. The importance of this peculiarity is that in using SDE% to predict the value of a business, it becomes increasingly essential to select a sample of comparables that are as close in revenue size to the subject as possible, and that are from similar SIC classifications. Otherwise, we might look at the 25.3% SDE% of a

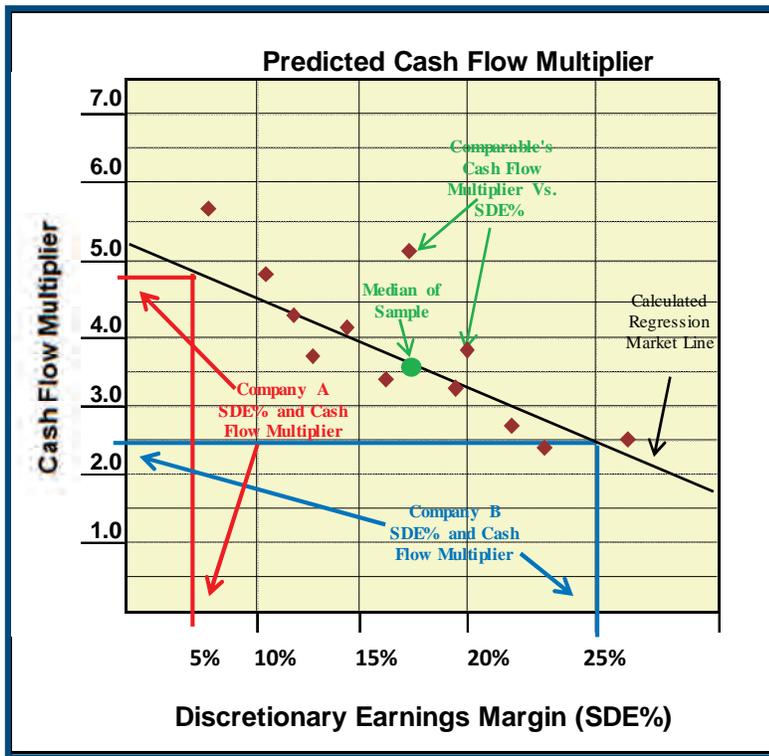
\$500,000 company and draw the false conclusion that it deserves better Market Value Multipliers than the \$2 million which only produced an SDE% of 15.6%.

7.5.4.2 THE LEVEL OF A COMPANY’S SDE% VS. ITS CASH FLOW MULTIPLIER

A second oddity that one must be aware of when comparing the companies of similar size and SIC classification is that: *the higher their SDE%, the lower their Cash Flow Multipliers tend to be.* This seemingly contradicts everything we know about Market Approach science. We just presumed that highly profitable companies that enjoyed higher profit margins would also earn higher Cash Flow Multipliers than their underperforming counter-parts. This is not the case!

From Exhibit XXIV we observed that larger companies generally earned higher Cash Flow Multipliers and Revenue Multipliers. Clearly, the size of a company is a major driver to the size of its Cash Flow Multiplier. However, if we look at companies within a narrow range of revenues we can see that there is a considerable range in their respective multipliers. For example, companies with revenues in the \$1 million to \$2 million range earned a median 2.67 Cash Flow Multiplier which, on the average, was considerably higher than the 2.05 multiplier earned by \$500,000 companies. Yet, when we look at the *range of multipliers* for the \$1 to \$2 million group we find that the lower quartile only earned a 1.76 multiplier whereas, the upper quartile earned 3.85. *This range of multipliers within a specific size grouping can largely be explained by the level of a company’s SDE%.*

Exhibit XXIX Predicting Cash Flow Multipliers Using SDE%



A statistical analysis of the Pratt’s Stats database clearly shows this relationship.

A regression analysis was initially performed on the entire Pratt’s Stats database of 11,500 sold transactions comparing a company’s SDE% with its corresponding Cash Flow Multiplier.³⁷ The R-Squared of the regression was only .18. Since this factor is low (0 means no correlation and 1.0 means perfect correlation), one could not conclude that SDE% is a good indicator of a company’s Cash Flow Multiplier. However,

³⁷ The database was first filtered by removing all transactions where Cash Flow Multipliers were greater than 10 or less than 0, and all corporate stock transfers. There were 4,811 transactions in this filtered sample.

when we filter the Pratt's Stats database further by including only companies near the same revenue level as the subject and that are in a similar SIC Code, the resulting regression produces an R-Squared significantly higher, usually from .40 to .70 or more. *In other words, when we select a small sample of companies that have a similar revenue level and SIC Code as the subject, the subject's SDE% becomes a reasonably good predictor of its potential Cash Flow Multiplier.*

However, from the graph in Exhibit XXIX we note that the regression Market Line is in a *downward slope*. This means that as a company's SDE% increases, we move to the right on the horizontal X-axis. However, the regression Market Line shows that we will also be moving downward on the vertical Y-axis, indicating a decreasing Cash Flow Multiplier. Thus for a given level of revenue, those companies that are more profitable and therefore, have a higher SDE%, will generally earn a lower Cash Flow Multiplier.

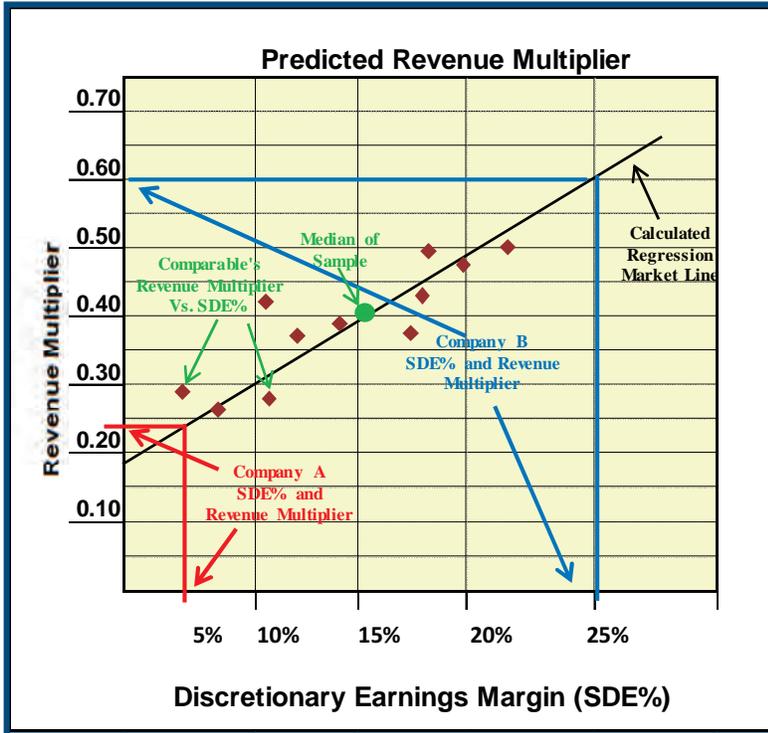
This oddity is easily explained by the example diagrammed in Exhibit XXIX. Company A (diagrammed in red lines), with revenues of \$500,000 and discretionary earnings of \$24,000, sold for \$110,000. Therefore, its SDE% is $\$24,000 \div \$500,000 = 4.8\%$, and, its Cash Flow Multiplier is $\$110,000 \div \$24,000 = 4.6$. (Observe where the red lines cross the horizontal axis at 4.8% and vertical axis at 4.6.) Company B (diagrammed in blue), also with \$500,000 in revenues, but with \$125,000 in discretionary earnings, sold for \$300,000. As we would expect, Company B sold for more money because it had higher earnings (in absolute dollar terms). However, Company B only produced a Cash Flow Multiplier of 2.4 ($\$300,000 \div 125,000$), but had a high SDE% of 25% ($\$125,000 \div \$500,000$). (Observe where the blue lines cross the horizontal axis at 25% and vertical axis at 2.4.) Company A's high Cash Flow Multiplier was not a function of a high selling price, but rather the function of a very low level of discretionary earnings, the denominator of the equation.

Appraisers often use the median Cash Flow Multiplier for the whole sample of comparables to value a business. In the above example, the median was 3.5. If we merely used the median Cash Flow Multiplier to estimate Company A and B's probable selling prices, we would have priced A at \$84,000 ($3.5 \times \$24,000$) and B at \$437,500 ($3.5 \times \$125,000$). We would have been way low on the first valuation and way high on the second. However, by using the regression formula and subject's SDE% to calculate its Cash Flow Multiplier, we would have determined that the company with a low SDE% would have earned a high Cash Flow Multiplier (4.6), which yielded a lower price of \$110,000, and the company with the high SDE% would have earned a low Cash Flow Multiplier (2.4), which still yielded a higher price of \$300,000. Thus by using regression analysis the resulting predicted values of the two companies would be much more accurate.

7.5.4.3 THE LEVEL OF A COMPANY'S SDE% VS. ITS REVENUE MULTIPLIER

When regressing the SDE% against the Revenue Multipliers of a sample of comparables, the resulting R-Squared factor is even more compelling than we found above when regressing SDE% against the Cash Flow Multipliers. The R-Squared factor typically rises as high as .80 or more, indicating that there is a very strong correlation between a company's SDE% and its Revenue Multiplier. In addition, Revenue Multipliers follow a more logical pattern. From the

Exhibit XXX Predicting Revenue Multipliers Using SDE%



graph at the left we can see that companies with a higher SDE% also earn higher Revenue Multipliers, just the opposite of what we saw with the Cash Flow Multipliers.

By applying the data from the example above to this graph, we see that Company A only had a SDE% of 4.8% and, as a result, the regression equation predicted a weak Revenue Multiplier of .22. Company B, however, had a strong SDE% of 25% and, accordingly, earned an equally strong Revenue Multiplier of .60.

Again, if we only decided to use the sample's median Revenue Multiplier of 0.40, the calculated value for both companies would have been the same - \$200,000 (.40 x \$500,000). Simple logic

would tell us that both companies are not worth the same; even though they both generated \$500,000 in revenues, the second company earned five times as much cash flow! *The Regression properly accounts for the difference in a company's profitability when calculating the Gross Revenue Multiplier, whereas, the median of the sample does not.*

From all the above statistical testing we can conclude that comparables within narrow revenue range and in the same SIC classification behave in similar and predictable ways, a point appraisers have always contended. By using Regression Analysis we employ that similarity by using a company's SDE% to predict its Revenue Multiplier, Cash Flow Multiplier, and Enterprise Multiplier.

8.0 RECONCILIATION OF MARKET APPROACH MULTIPLIERS

8.1 BUILDING THE SAMPLE TO BE USED IN THE ANALYSIS

The above six sections set up the filtering process that will be applied when selecting comparable transactional data. These selected guideline companies are considered to possess a higher degree of similarity to the Subject's characteristics and, therefore, are directly comparable.

The Subject Company is classified under SIC Code #34, Fabricated metal products. Companies listed under these classifications may not be identical to the subject; however, they

may possess many similar characteristics. From a buyer's perspective, then, most of the companies within this group would be equally desirable choices.

The search criteria used for selecting comparables from the databases, therefore, began by searching SIC Code #34. A total of 448 transactions were found in the classification. The selection was further filtered to include just those companies whose revenues were between \$3,000,000 and \$30,000,000, with the transactions occurring after 2004 and whose description of operations was similar to the Subject (i.e. Sheet Metal Fabrication). A total of 33 comparables were found in the Pratt's Stats database, and 13 were found in the BIZCOMPS database. As we discussed in the Appendix on Page 105, many transactions are frequently flawed or are inappropriate comparisons to the Subject and should be removed from the sample. These usually include transactions with Cash Flow Multipliers greater than 10 or less than zero; transactions with SDE% greater than two standard deviations higher than the sample's average SDE%; Stock sales that could not be reconciled to Asset Sales; and transactions that also included the sale of real estate. After removing these outliers a total of 10 comparables were found in the Pratt's Stats database and 10 were found in the BizComps database,

The Comparables Analysis Table in Exhibit XXXI below shows the operating ratios of 20 businesses that were selected by using the filtering criteria discussed in Section 6.0 above. Specific details on all of these companies can be found in the appendix beginning on Page 126

All the transactions in the databases are presumed to be "Asset Sales," or, transactions that can be reconciled to Asset Sale Pricing; that is, their selling prices are comprised of Inventory, Fixtures, and Intangibles only. Those companies exhibiting very high Revenue Multiples often have either real estate, accounts receivable, or other non-operating assets included in their reported selling price, and, the transactional data neglected to disclose this fact. Many of the comparables with low Revenue Multiples may have reported their selling prices net of inventory, or, the buyer assumed some of the liabilities of the company, thereby reducing the price. Again, the transactional data may not have disclosed this fact. It only takes one or two comparables in a small sample with improper sales data to distort the Market Value Multiples.

Sold Comparables Analysis										
Observations	Listing Price	Selling Price	Gross Revenues	Revenue Multiplier	Cash Flow	SDE%	Cash Flow Multiplier	Inventory	Enterprise Multiplier	Fixtures & Equip
1		3,062,000	11,618,000	0.26	502,000	4.3%	6.10	2,173,000	1.77	1,389,000
2	1,622,000	1,422,000	3,846,000	0.37	213,000	5.5%	6.68	122,000	6.10	3,348,000
3	1,350,000	1,100,000	5,632,000	0.20	319,000	5.7%	3.44	354,000	2.33	366,000
4	650,000	625,000	4,790,000	0.13	300,000	6.3%	2.08	5,000	2.07	40,000
5	2,500,000	2,500,000	7,387,000	0.34	702,000	9.5%	3.56	1,384,000	1.59	1,000,000
6	2,800,000	1,762,000	3,090,000	0.57	302,000	9.8%	5.83	478,000	4.25	82,000
7		7,005,000	28,640,000	0.24	2,820,000	9.8%	2.48	2,172,000	1.71	292,000
8	870,000	692,000	3,878,000	0.18	406,000	10.5%	1.70	100,000	1.46	348,000
9	940,000	940,000	3,705,000	0.25	404,000	10.9%	2.33	40,000	2.23	309,000
10		3,431,000	6,292,000	0.55	756,000	12.0%	4.54	816,000	3.46	379,000
11	2,700,000	1,662,000	3,443,000	0.48	417,000	12.1%	3.99	425,000	2.97	595,000
12	1,500,000	1,323,000	4,998,000	0.26	684,000	13.7%	1.93	18,000	1.91	412,000
13		10,500,000	15,232,000	0.69	2,339,000	15.4%	4.49	362,000	4.33	2,545,000
14	5,200,000	4,436,000	8,491,000	0.52	1,345,000	15.8%	3.30	1,062,000	2.51	639,000
15	1,100,000	1,050,000	4,305,000	0.24	686,000	15.9%	1.53	79,000	1.42	83,000
16	3,400,000	3,261,000	4,284,000	0.76	690,000	16.1%	4.73	130,000	4.54	1,200,000
17	1,900,000	1,800,000	3,098,000	0.58	512,000	16.5%	3.52	175,000	3.17	310,000
18	3,000,000	2,340,000	4,998,000	0.47	936,000	18.7%	2.50	650,000	1.81	1,500,000
19	3,000,000	3,000,000	4,541,000	0.66	980,000	21.6%	3.06	350,000	2.70	100,000
20	14,932,000	10,185,000	16,868,000	0.60	4,297,000	25.5%	2.37	1,466,000	2.03	2,900,000
21										
22										
23										
24										
25										
Avg:	2,373,000	3,105,000	7,457,000	↓	981,000	↓	↓	618,000	↓	892,000
	Selling Price / Listing Price = 85.9%			Gross Rev Range		CF Margin Range	Cash Flow Range		Enterprise Range	
			Median =	0.42		12.1%	3.37*		2.28*	
			Average =	0.42		12.8%	3.51*		2.72*	
			Standard Deviation =	0.19		5.53%	1.50*		1.25*	

* Companies with Cash Flow Multiples that are negative or greater than 10 are ignored in this calculation.

In order to test the predictive value of a small sample, we can compare the variability of the observations in the sample with that of the entire database. The relative variability is measured by the Coefficient of Variation (CV) -- the lower the coefficient, the higher the predictive value of the sample. The findings are as follows:

Exhibit XXXII Coefficients of Variation of Sample vs. Total Database

20 (Observations)

Database Exhibit XXIV & Exhibit XXXI	Gross Income Multiplier	Cash Flow Multiplier	Enterprise Value Multiplier
Sample – 20 Observations	36.1%	40.5%	47.2%
Total Database - 12,537 Obs. Pratt's Stats-Any State	84.1%	68.2%	90.9%

All three of the procedures applied to the 20 observations in the sample yielded significantly lower (superior) degrees of variability than the entire Pratt's Stats database. Therefore, we can assume that this sample is a reasonably good measure of the identified market size and should have good predictive abilities. To further test the predictive abilities of this sample of guideline companies, a regression analysis was done.

8.2 MULTIPLE REGRESSION TEST

The first of the four regression tests described in Section 7.5.3 to be performed on the above sample is the multiple variable regression test which takes the four main variables describing each guideline company's operations (inventory, SDE, FF&E, and gross revenues) and plots them against the company's selling price. From this test we can statistically identify those comparables that are "outliers," that is, those companies whose selling prices are well above or below what the rest of the market earned.

The 20 comparables from Exhibit XXXI above were regressed at a 95% confidence level, and, the results are shown in the Exhibit XXXIII below.

The test yielded an R Squared factor of 0.87. A factor of zero (0.0) means that the sample had no predictive characteristics at all, whereas, a 1.0 indicates perfect predictability. A .50 factor suggests modest predictability. The test also produces a Standard Error, which is a statistical measurement similar to the Standard Deviation. That is, 16% of the predicted values will exceed the actual selling price of the company by the Standard Error, and, 16% will be less.

Observations	Actual Values For Comparables					Calculated Values	
	Gross Revenues	Cash Flow	Inventory	Fixtures	Actual Sold Price	Predicted Price	Outlier Cutoff +/-1,524,223
	1	11,618,361	501,997	2,172,570	1,388,694	1	3,061,508
2	3,846,000	213,000	122,000	3,348,000	2	1,422,000	2,852,716 (1,430,716)
3	5,632,127	319,497	354,409	366,306	3	1,100,000	1,423,877 (323,877)
4	4,790,000	300,000	5,000	40,000	4	625,000	1,193,402 (568,402)
5	7,387,240	701,957	1,384,415	1,000,000	5	2,500,000	2,442,861 57,139
6	3,089,670	302,103	478,328	82,422	6	1,762,398	920,698 841,700
7	28,639,549	2,819,950	2,172,055	292,377	7	7,005,000	8,075,425 (1,070,425)
8	3,878,000	406,000	100,000	348,000	8	692,000	1,453,097 (761,097)
9	3,705,000	404,000	40,000	309,000	9	940,000	1,423,082 (483,082)
10	6,291,996	755,901	815,796	378,906	10	3,431,341	2,205,055 1,226,286
11	3,443,000	417,000	425,000	595,000	11	1,662,000	1,490,652 171,348
12	4,998,000	684,000	18,000	412,000	12	1,323,223	2,153,936 (830,713)
13	15,232,287	2,339,134	362,316	2,544,625	13	10,500,000	7,530,014 2,969,986
14	8,491,331	1,344,932	1,062,440	639,129	14	4,435,631	3,638,271 797,360
15	4,305,000	686,000	79,000	83,000	15	1,050,000	1,873,962 (823,962)
16	4,284,000	689,700	130,000	1,200,000	16	3,260,700	2,525,307 735,393
17	3,098,000	512,000	175,000	310,000	17	1,800,000	1,527,649 272,351
18	4,998,000	936,000	650,000	1,500,000	18	2,340,000	3,109,664 (769,664)
19	4,541,000	980,000	350,000	100,000	19	3,000,000	2,393,116 606,884
20	16,868,000	4,297,000	1,466,000	2,900,000	20	10,185,000	11,315,165 (1,130,165)
21					21		
22					22		
23					23		
24					23		
25					24		
= Outliers							
Actual Data		Regression	Calculated	Standard Error = \$1,172,479			
All Fab Precision Sheetmetal		Coefficients	Price	Selected Cutoff Multiple = x 1.3			
Total Sales	\$15,852,181	x 0.1067 =	1,691,980	Outlier Cutoff = \$1,524,223			
Total Cash Flow	\$2,479,985	x 1.8801 =	4,662,701	R Square = 0.87			
Total Inventory	\$725,801	x (0.2540) =	-184,350	CV = 37.8%			
Norm. F&E+Ten Im	\$4,170,000	x 0.5905 =	2,462,368	An R Square value of 0.0 means the above sample had no predictive value. An R Square of 1.0 means the sample had perfect predictive values. A value over .50 means the above sample had a reasonably good predictive value.			
Regression Intercept Value =			95,752				
Price Predicted by Regression =			8,728,451				
Upper 16% (one Std Error) = + \$1,172,479			9,900,930				
Lower 16% (one Std Error) = - \$1,172,479			7,555,972				
Regression Formula:							
Sales x 0.1067 + Cash Flow x 1.8801 + Inventory x -0.254 + Fixtures x 0.5905 + \$95,752 = Calculated Price							

In the sample of comparables shown above, three such comparable was found to have calculated values that deviated from the actual selling price by more than or less than the Standard Error cut-off point. These guideline companies are considered 'outliers' and were removed from the sample. One company sold for \$10,500,000, whereas the regression

predicted a much lower \$7,530,014. A second company sold for \$3,431,341 with the regression predicting a much lower \$2,205,055. A third sold for \$3,260,700 with a prediction of \$2,525,307.

The three outlying comparables were removed from the sample and the remaining sample of 17 comparables was regressed a second time. The results are shown in the two tables below. The refined Regression Analysis produced an R Squared of 0.98 which is an improvement over the original sample of 20 indicating that it is a superior measure of the market. The Regression Equation that was constructed is shown at the bottom of the Exhibit XXXIV. The actual values

Observations	Refined Regression						
	Actual Values For Comparables					Calculated Values	
	Gross Revenues	Cash Flow	Inventory	Fixtures	Actual Sold Price	Predicted Price	\$ Difference
1	11,618,361	501,997	2,172,570	1,388,694	1	3,061,508	3,151,905 (90,397)
2	3,846,000	213,000	122,000	3,348,000	2	1,422,000	1,055,010 366,990
3	5,632,127	319,497	354,409	366,306	3	1,100,000	1,086,269 13,731
4	4,790,000	300,000	5,000	40,000	4	625,000	689,535 (64,535)
5	7,387,240	701,957	1,384,415	1,000,000	5	2,500,000	2,946,839 (446,839)
6	3,089,670	302,103	478,328	82,422	6	1,762,398	1,297,585 464,813
7	28,639,549	2,819,950	2,172,055	292,377	7	7,005,000	6,917,452 87,548
8	3,878,000	406,000	100,000	348,000	8	692,000	1,101,128 (409,128)
9	3,705,000	404,000	40,000	309,000	9	940,000	1,039,414 (99,414)
10	3,443,000	417,000	425,000	595,000	10	1,662,000	1,520,211 141,789
11	4,998,000	684,000	18,000	412,000	11	1,323,223	1,542,226 (219,003)
12	8,491,331	1,344,932	1,062,440	639,129	12	4,435,631	3,857,689 577,942
13	4,305,000	686,000	79,000	83,000	13	1,050,000	1,614,591 (564,591)
14	3,098,000	512,000	175,000	310,000	14	1,800,000	1,445,173 354,827
15	4,998,000	936,000	650,000	1,500,000	15	2,340,000	2,861,754 (521,754)
16	4,541,000	980,000	350,000	100,000	16	3,000,000	2,508,269 491,731
17	16,868,000	4,297,000	1,466,000	2,900,000	17	10,185,000	10,268,711 (83,711)

Applied Regression Coefficients				Standard Error = \$419,885 R Square = 0.98 CV = 15.9%
Actual Data		Regression Coefficients	Calculated Price	
All Fab Precision Sheetmetal				
Total Sales	\$15,852,181	x (0.0586) =	-929,418	
Total Cash Flow	\$2,479,985	x 2.1082 =	5,228,318	
Total Inventory	\$725,801	x 1.0546 =	765,441	
Norm. F&E+Ten Im	\$4,170,000	x 0.1119 =	466,607	
Regression Intercept Value =			328,163	
Price Predicted by Regression =			5,859,112	
Upper 16% (one Std Error) = + \$419,885			6,278,997	
Lower 16% (one Std Error) = - \$419,885			5,439,227	

An R Square value of 0.0 means the above sample had no predictive value. An R Square of 1.0 means the sample had perfect predictive values. A value over .50 means the above sample had a reasonably good predictive value.

Regression Formula:
Sales x -0.0586 + Cash Flow x 2.1082 + Inventory x 1.0546 + Fixtures x 0.1119 + \$328,163 = Calculated Price

The last point of analysis for the sample of 17 observations is the comparison of the Coefficients of Variation for each of the calculated Market Value Multiples with the CV's for the original sample of 20, as well as the entire Pratt's Stats database. Those statistics are compiled in Exhibit XXXVI below. All four regression methodologies in the second more narrowly defined sample of 17 observations produced lower (superior) Coefficients of Variation. The smaller sample also produced a higher (superior) R Squared factor. Thus, the smaller sample appears to be a better indicator of the market than the sample with 20 observations. The Market Value Multipliers calculated from this sample will, therefore, be used in the analysis, and, the results from the larger database will be rejected.

Exhibit XXXVI Coefficients of Variation of Samples vs. Total Database (17
Observations vs. 20 Observations)

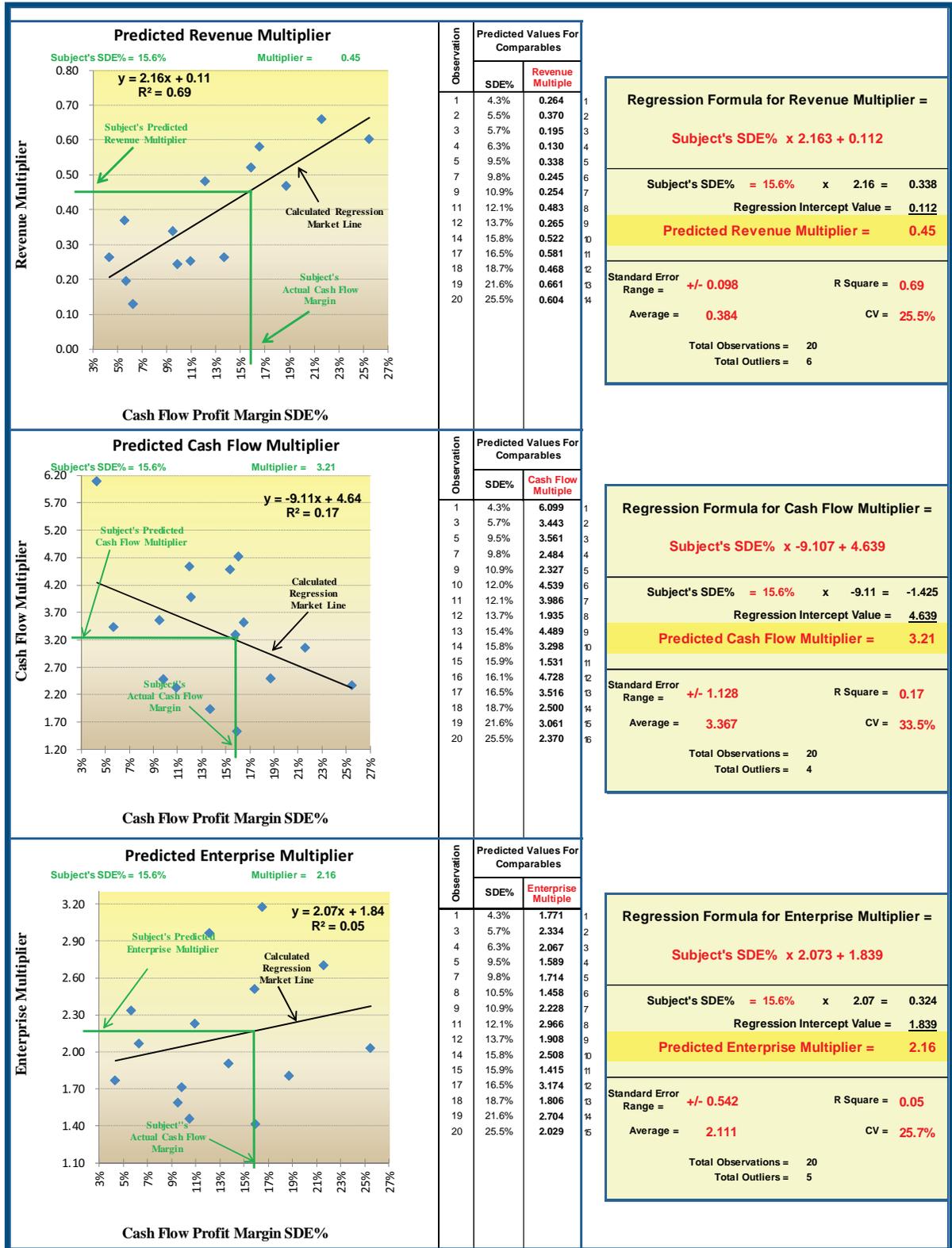
Database, Exhibit XXIV, Exhibit XXXI, Exhibit XXXV	Gross Income Multiplier	Cash Flow Multiplier	Enterprise Value Multiplier	Regression Analysis
Sample – 17 observations	25.5%	33.5%	25.7%	15.9%
Sample – 20 observations	36.1%	40.5%	47.2%	37.8%
Total Database–12,537 Observations-Pratt's Stats	84.1%	68.2%	51.2%	

8.3 CALCULATING THE THREE MARKET MULTIPLIERS

From the above analysis, we have arrived at a range of values for our Subject by means of the Multiple Variable Regression Analysis, which is the first of the four procedures that we are using in the Market Approach. The remaining three procedures will calculate the values for the Revenue, Cash Flow, and Enterprise Multipliers. As noted earlier we will perform a regression analysis on each of the comparables' three Market Value Multipliers against its SDE% (Cash Flow Profit Margin). From each regression, then, we will obtain an equation that calculates the Market Line for the Subject's Revenue Multiplier, Cash Flow Multiplier, and Enterprise Multiplier. By "plugging" in our Subject's SDE% into the regression equations, we will solve for the Subject's three Market Value Multipliers. *The resulting values, then, are the Multipliers that the market expects given the level of the Subject Company's Cash Flow Profit Margin.*

Below are the details of that analysis:

Exhibit XXXVII Calculation of the Three Market Value Multipliers



The predicted multipliers calculated by inputting the Subject's SDE% of 15.6% into the above regression formulas are summarized as follows:

Revenue Multiplier:

$$\text{Subject's SDE\%} \times 2.163 + 0.112 = 0.45$$

Cash Flow Multiplier:

$$\text{Subject's SDE\%} \times -9.107 + 4.639 = 3.21$$

Enterprise Multiplier:

$$\text{Subject's SDE\%} \times 2.073 + 1.839 = 2.16$$

8.4 APPLYING THE MARKET VALUE MULTIPLIERS

We have now calculated the Market Value Multipliers based on the three procedures above plus the regression formula from the multiple regression analysis in Exhibit XXXIV. These four methods will produce values that represent the market's expectations given the level of the Subject's SDE%. However, the calculated values represent the "closest fit" of the observations found in the market place at the Subject's current level of profitability.

According to Shannon Pratt, "Simply applying the chosen measure of central tendency of a group of guideline company multiples more often than not fails to capture differences in the characteristics between our subject company and the guideline companies as a group. ... a company with an above average return on sales [a reference to SDE% or similar profit margin measure] would usually be accorded an above average price/sales or MVIC/sales multiples. ... Keep in mind that the two factors that influence the selection of multiples of operating variables the most are the growth prospects of the subject company relative to the guideline companies and the risk of the subject company relative to the guideline companies." To that end Mr. Pratt suggests, one might adjust an observed multiple upward or downward by a percentage, or, even place it in the upper or lower quartile of the sample's range.³⁸

Thus, if we have reason to believe that the Subject's profitability will change at a greater rate than its peer group in the future, we should consider adjusting the calculated multipliers up or down before we apply them to our Subject. For example, if we believe the Subject might double its SDE% in the coming years, while the rest of its peers only increase by 50%, we have justification for increasing the calculated multipliers. However, if we expect the Subject to improve its profitability at a similar rate as its peers, then even though the Subject's profitability is higher, it is still at the same level of profitability *relative* to its peers and its position on the calculated Market Line will be the same. If such is the case, no adjustment to the multipliers is warranted.

³⁸ Shannon Pratt, The Market Approach to Valuing Businesses. (New York: John Wiley & Sons, Inc, 2000), p.134

In that light, we should consider such things as: will the Subject’s market grow more rapidly than that of its peers? Are there any major changes expected in the Subject’s current mode of operations that may significantly change its profitability in the future?

The Subject’s SDE%, which was used to calculate its Market Value Multipliers, was in between the mid and upper range exhibited by the comparables group. We must then consider whether the Subject’s financial condition or market strength might change this level of profitability, thus giving reason to adjust its multipliers up or down.

The demographics of the Subject Company’s market area have been above average since the end of the recession compared to the nation as a whole. The population growth in the region has been above average for the last seven years, as has household income growth. Unemployment has also been moderately below the national levels. From the financial statement analysis we determined that the Company’s five-year revenue growth has been above the growth rate of the industry. However, the company’s ability to generate cash flow (as measured by EBITDA plus Owner’s Compensation) is only slightly higher than its peers and the strength of its balance sheet is about average. Thus, the Subject’s current level of SDE%, which is in between the mid and upper range, appears to appropriately reflect its economic potential. Therefore, no additional adjustment to the Subject’s Market Value Multipliers is warranted.

The selected Market Value Multipliers and the resulting calculated Asset Sale Values for each procedure are as follows:

Exhibit XXXVIII Market Value Multiples Applied to Subject

Range of Market Value Multiples at Different Levels of Profitability					
SDE% Range	Gross Revenue	Cash Flow	Enterprise Value	Regression	
Lowest 16% of Comps have SDE% of 6.6% =	0.25	4.04	1.97		
Mid Range of Comps have SDE% of 12.5% =	0.38	3.50	2.10	5,859,112	
Highest 16% of Comps have SDE% of 18.4% =	0.51	2.96	2.22		
Subject's SDE% = 15.6%	Revenue Multiplier	Cash Flow Multiplier	Enterprise Multiplier	Multi-Variable Regression	The Selected Market Value Multiples are between the mid and upper range of the Regression Market Line
Subject's Operation =	\$15,852,181	\$2,479,985	\$2,479,985		
Multiplier at Subject's Level of Profitability =	x 0.45	x 3.21	x 2.16		
Inventory =			5,356,769	5,859,112	
Indicated Value =	\$7,133,481	\$7,960,753	\$6,082,570		
			+ 725,801		

Further adjustments to the above Asset Sale Values must be made to arrive at the market value of the Corporation’s Equity or Net Worth. The value of the Net Worth of HiTech Precision

Sheetmetal, Inc. can be reconciled by taking the Asset Sale Values above and adjusting them for the additional assets and liabilities that were not included in a conventional Asset Sale.

The adjustments to the Asset Sale Values are as follows:

Exhibit XXXIX Adjustments to Asset Sale Values

Additional Assets as per the Normalized Balance Sheet for December 31, 2014:
(See Exhibit XV)

Cash and Equivalent	\$814,074	
Accounts Receivable	2,045,025	
Employee Receivables	80,975	
Prepays, Deposits	85,048	
Total Additional Assets		\$3,025,122

Additional Liabilities as per the Normalized Balance Sheet for December 31, 2014:

Accruals	\$294,495	
Credit Cards	\$20,333	
Accounts Payable	\$682,537	
Notes, Lines of Credit	\$375,000	
Long-Term Debt	\$629,340	
Deferred Taxes	\$10,000	
Total Additional Liabilities		(\$2,011,705)

Total Net Adjustments (rounded) \$1,013,000

<u>Procedure</u>	<u>Gross Revenue Multiplier</u>	<u>Cash Flow Multiplier</u>	<u>Enterprise Multiplier</u>	<u>Regression Analysis</u>
Asset Sale Value	\$7,133,481	\$7,960,753	\$6,082,570	\$5,859,112
Less: Net Adjustments	<u>1,013,000</u>	<u>1,013,000</u>	<u>1,013,000</u>	<u>1,013,000</u>
Total Equity Value	<u>\$8,146,481</u>	<u>\$8,973,753</u>	<u>\$7,095,570</u>	<u>\$6,872,112</u>

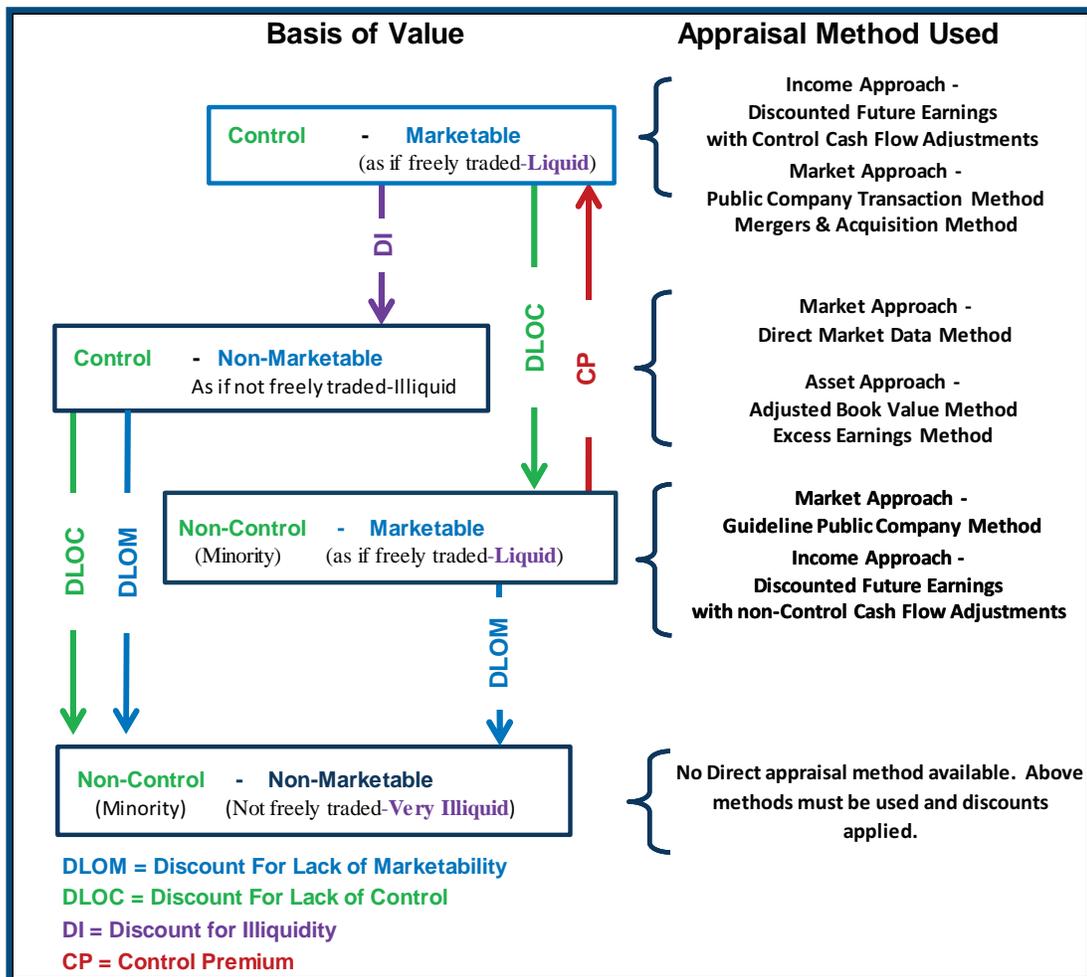
The above values are for a 100% interest in the Subject's net worth on a *controlling, non-marketable* basis. The value that was calculated under the Income Approach was on a *controlling, marketable* basis. Our next step is to determine appropriate discounts, if any, to bring our Subject's values in line with a *controlling, non-marketable* basis. The following is a discussion of potential Discounts for Lack of Control and Discounts for Lack of Marketability.

9.0 MARKETABILITY DISCOUNT AND CONTROL DISCOUNT

The various methodologies used by the appraiser create a value that presumes either a control or a minority ownership position and a marketable or non-marketable characteristic. If the methodology used develops a value that is from a minority owner’s perspective and we desire a control value, an increase in that calculated minority value is indicated. Likewise if the value developed by the methodology is on a control basis and we seek a minority ownership value, we should consider a decrease in that calculated control value. The same logic applies to the level of marketability presumed by the methodology.

The following chart illustrates the different levels of value created by different methodologies used and what type of adjustment must be made to move that basis to the desired level exhibited by the subject. The column on the right shows various types of methodologies used in valuations and the column on the left indicates the level of control and marketability that they produce. For example, if one used the Discounted Future Earnings method with control adjustments, the value produced would be on a control/marketable basis. Consequently, if one used this methodology to value a non-controlling minority interest, a Discount for Lack of Control (DLOC) would be required.

Exhibit XL Basis of Value Adjustments



As we noted in the beginning of this report, the basis of value that we are seeking for the Subject Company is from a controlling, non-marketable perspective. From the table above we see that by using control adjustments to calculate net free cash flow in the Income Approach, the resulting basis of value is controlling. In addition, the Discount and Capitalization Rates that were used in the Income Approach were calculated from data observed in the stock market. As such the rates presuppose that the investment is in publicly traded companies that have ready access to markets. In other words, the Income Approach method used in this report coupled with the manner in which net free cash flow was calculated implies that the basis for the above value is controlling and marketable. **Consequently, to bring the value that we developed in the Income Approach in line with the actual characteristics of the Subject, we will need to apply a Discount for Illiquidity.**

The table above indicates that the Direct Market Data Method uses data from privately-held companies where a 100% controlling interest is transacted. Thus, the basis of value here is controlling. In addition, one cannot sell a privately-held company with the same ease as selling a stock on the stock market. Consequently, transactions using the Direct Market Data Method are considered non-marketable by comparison. Thus, the basis produced by the Direct Market Data Method is in line the characteristics of our subject.

9.1 CONTROL PREMIUMS AND DISCOUNTS

In this assignment we are valuing a 100% controlling interest; therefore, no discount for lack of control is warranted.

9.2 DISCOUNT FOR LACK OF MARKETABILITY

“Marketability is defined as the ability to convert the investment to cash very quickly at minimum costs, and with a high degree of certainty of realizing the anticipated amount of proceeds.”³⁹ The prime example of perfect marketability can be seen with stocks traded on public stock exchanges. They can be sold within seconds at a reasonably expected price for a transaction fee of as little as \$7.95. The proceeds can be collected in three days.

Investments in closely held companies are a different story. There are no ready markets to trade shares of closely held companies. As such, the length of time to consummate a sale can be lengthy with the selling price not known until an offer is tendered. Sales commissions can range from 4% to 10% of the selling price and legal, accounting, and escrow costs can range between 1% and 3%.⁴⁰ Investors abhor illiquidity and demand fairly large discounts to be induced into making such investments. Interests in small, closely held companies, therefore,

³⁹ Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweih, Valuing a Business: The analysis and appraisal of closely held companies, 4th edition (New York, NY: McGraw-Hill, 2000), p 26

⁴⁰ The Appraiser has been a business broker with Murphy Business and Financial and Sunbelt Business Brokers. Typical sales commissions charged by these two institutions were 10% on the first million dollars, 8% on the second million dollars, 6% on the third million on 4% on four million dollars and above. The Appraiser has also represented numerous sellers whose legal, accounting and escrow costs were as high as \$125,000 on a four million dollar transaction and as low as \$1,000 on a \$100,000 transaction.

are referred to as non-marketable. A non-marketable interest must, therefore, be valued in a manner which will reflect its unattractive investment characteristics.

As in the case of control premiums above, the methodology used to develop a given value drives the need for possible Discounts for Lack of Marketability (DLOM). If the methodology used by the appraiser employs a data source of marketable type securities, the resulting calculated value will also have the presumption of marketability. If, then, we are seeking a non-marketable value for the subject, the marketable value that was initially calculated must be further reduced by an appropriate DLOM.

The appraisal profession generally recognizes two different levels of marketability discounts. Clearly the degree of difficulty of selling a minority interest in a closely held company is far greater than selling a 100% controlling interest. Any business broker will tell you that there is virtually no market for the sale of minority shares of a company. The primary choice facing such an owner is to sell his shares to his other partners. If the majority partners are oppressing minority partners, the last remaining choice is litigation. As such, non-marketable interests are referred to as “not freely traded - very illiquid” in Exhibit XL.

The owner of a controlling interest has far more options in marketing his business. If the company is large enough, the owner can consider taking it public or selling to an ESOP or private equity groups. In the case of smaller companies a majority owner can employ the services of a business broker to sell his company. None of these options are available to a minority owner as a minority owner cannot force the sale of any company assets without majority approval. As such, many practitioners argue that there is little, if any, marketability discount for controlling interests.

However, all the options available to a majority owner still have costs involved that are significantly greater than the investor who pays E-Trade \$7.95 to sell his publically traded shares. The U.S. tax court clearly has recognized such discounts for controlling interests. From the 1982 case of *Estate of Andrews v. Commissioner*: “Even controlling shares in a nonpublic corporation suffer from lack of marketability because of the absence of a ready private placement market and the fact that flotation costs would have to be incurred if the corporation were to publically offer its stock.” Shannon Pratt concurs in his book, *Business Valuation Discounts and Premiums*. He notes that whether a buyout or public offering is sought, the owner is faced with: 1) creating accounting records satisfactory to buyers, bankers, or regulatory authorities; 2) utilizing management’s time to facilitate the above and cure negative factors; 3) incurring legal expenses; and, 4) finding a buyer [which usually means employing the services of a broker].⁴¹

In order to differentiate between the marketability discounts for controlling versus non-controlling interests, the discount applied to non-controlling interests is referred to as a Discount for Lack of Marketability and the discount applied to controlling interests is referred

⁴¹ Shannon P. Pratt, Business Valuation Discounts and Premium, (New York: John Wiley & Sons, Inc. 2001), p. 173

to as an Illiquidity Discount. Thus, for our Mergers and Acquisitions Method we find that an Illiquidity Discount is appropriate.

The following considerations were taken into account to estimate the Illiquidity Discount that will be applied to the value calculated under the Income Approach Method. Three common vehicles to selling a privately held company are a public offering using an investment banker, a direct placement with a private equity group, or a private sale using a business broker. The Subject Company is too small to use the first two resources. Thus, the remaining marketing option is enlisting the services of a private equity group or business broker. As noted in the footnote #38 above, a commission on a company the size of the Subject would be in the range of 5% to 7%. Legal, accounting and escrow fees can range from 1% to 3%.

Total marketing costs and, therefore, the Illiquidity Discount are estimated at 8.0%.

The above Illiquidity Discount will be applied to the Income Approach in Exhibit XLI below.

10.0 RECONCILIATION OF ALL METHODOLOGIES

It is rare that the various procedures used would produce similar values. Each method is looking at different aspects of the company, so, it is reasonable to expect that they would produce different values as a result. Internal Revenue Ruling 59-60 requires that at least 50% of a value's weighting should be placed on income-based methodologies. According to the Uniform Standards of Professional Appraisal Practice (USPAP), "an appraiser must reconcile the indications of value resulting from the various approaches to arrive at the value conclusion." A simple average does not satisfy the standard, but rather, the appraiser must evaluate the relative merits of each procedure to form a conclusion. "The value conclusion is the result of the appraiser's judgment."⁴²

The various indications of value developed by the different procedures are now weighted and the final Valuation Conclusion is calculated. The discussion of the basis for the weightings follows the exhibit below. The values are also adjusted for non-operating assets that were initially removed from the Normalized Balance Sheet in Exhibit XV and for the appropriate marketing and controlling discounts discussed in Section 9.0.

⁴² *Uniform Standards of Professional Appraisal Practice*. The Appraisal Foundation, Washington, D.C., 2000, p. 65

Exhibit XLI Summary of Equity Values by Procedure

Procedure	Summary of Net Equity Values by Methodology				
	Market Approach (Page 94 & 96)				Income Approach (Page 59)
	Revenue Multiplier	SDE Multiplier	Enterprise Multiplier	Regression	
Asset Sale Value	\$7,133,481	\$7,960,753	\$6,082,570	\$5,859,112	
Balance Sheet Adjustments	<u>\$1,013,417</u>	<u>\$1,013,417</u>	<u>\$1,013,417</u>	<u>\$1,013,417</u>	
Total Net Worth Value - 100% Interest	\$8,146,898	\$8,974,170	\$7,095,987	\$6,872,529	\$6,428,000
Adjustment for DLOM (1 - 8%)	<u>None</u>	<u>None</u>	<u>None</u>	<u>None</u>	x 92%
100% Controlling, Non-mktble Interest	\$8,146,898	\$8,974,170	\$7,095,987	\$6,872,529	\$5,913,760
Weightings	x 18.1%	x 4.60%	x 1.4%	x 25.9%	x 50.0%
Net Weighted Values	\$1,474,589	\$412,812	\$99,344	\$1,779,985	\$2,956,880
* Total Weighted Value of a 100% Interest (Rounded)				\$6,720,000	
Six Million Seven Hundred Twenty Thousand Dollars					

The above value is for a 100% Interest in the Net Worth of HiTech Precision Sheetmetal, Inc. on a controlling, non-marketable basis as of December 31, 2014.

If by the close of escrow the inventory value of \$725,801 changes or the assets and liabilities comprising the \$1,013,000 Balance Sheet Adjustments change, the value of the Subject's Net Worth must be adjusted up or down accordingly.

Summary

The Adjusted Book Value approach is commonly used in divorce valuations because of its simplicity. However, to provide a high level of confidence, the Discrete Valuation of individual assets requires that the company have a high-integrity balance sheet, thus allowing individual tangible assets to be precisely valued. The process also requires all intangibles to be identified and valued separately. Since the Subject's balance sheet does not meet that high-integrity standard, the Collective Revaluation version of the Adjusted Book Value method was used. Groups of assets are valued at their depreciated replacement cost and all intangibles are collectively valued using the Excess Earnings method. *USPAP recommends that this approach only be used when no better means of valuing a business is appropriate. Since the Market Approach and Income Approach used in this report produced reliable valuations, this methodology is given a zero weighting.*

The Guideline Public Company Method uses a database of large publicly traded companies. A search of the database only found a few companies similar to the subject. However, they were all substantially larger than the subject was and, therefore, could not be used. A similar problem exists with the Mergers and Acquisition Method. All potential guideline companies

in the database, with the exception of one, were substantially larger than the Subject and, therefore, were not good comparables. Hence, these methods could not be used

Unlike the Market Approach, the Income Approach considers the impact of various balance sheet entries on a company's cash flow and uses projections of the future earnings capacity of the company. The Subject's high-level debt service will consume greater amounts of cash flow than its peer group. Therefore, the Income Approach reflects the Subject's operating realities far better than the four Market Approach methodologies and was assigned a 50% weighting.

The Market Approach does not take these cash-flow conditions into account. However, the Market Approach does reflect buyer demand which often only focuses on current revenues and discretionary earnings. As such, the Market Approach cannot be ignored. The guidelines advanced by IRS Ruling 59-60 set a preference for methodologies that are based on Cash Flow. Since all the regression methodologies that were employed in the Market Approach used a company's cash flow profit margin as an indicator of value, these methodologies satisfy the IRS mandate. As such a 50% weighting will be assigned to the four Market Approach procedures. The weightings will be apportioned based on the R Squared factor that each of the four Regressions exhibited. The higher the R Squared the more highly predictable the method is. Thus, the weightings will be distributed between the four Market Approach methodologies as follows: The Multiple Variable Regression Analysis generated the highest R Squared Factor of 97.9% and, therefore, was given a weighting of 25.9%. The Revenue Multiplier generated an R Squared Factor of 68.6% and, therefore was given a weighting of 18.1%. The Cash Flow Multiplier generated an R Squared Factor of 17.3% and, therefore was given a weighting of 4.6%. The Enterprise Multiplier generated the lowest R Squared Factor of 5.3% and, therefore was only weighted 1.4%.



C. Fred Hall, III, MBA, CBA, CVA

HiTech Precision Sheetmetal, Inc.

December 31, 2014

Exhibit XLII Discretionary Cash Flow Analysis

S-Corporation
April 1, 2015

	Accrual Basis			Accrual Basis			Accrual Basis		
	Dec 31, 2014	Add Backs		Dec 31, 2013	Add Backs		Dec 31, 2012	Add Backs	
	12 Mos.	Per P&Ls		12 Mos.	Per P&Ls		12 Mos.	Per P&Ls	
INCOME									
Sales	15,501,810		99.7%	16,599,389		100.0%	16,557,166		100.0%
Freight, Design	53,785	-	0.3%	2,266	-	0.0%	5,192	-	0.0%
TOTAL INCOME	15,555,595		100.0%	16,601,655		100.0%	16,562,358		100.0%
COST OF GOODS SOLD									
Beginning Inventory			0.0%	1,282,269		7.7%	1,370,322		8.3%
Raw Materials	3,924,052		25.2%	4,158,569		25.0%	6,600,766		39.9%
Work-in-Process	5,702		0.0%	441,184		2.7%	181,181		1.1%
Finished Goods	(59,138)		-0.4%	139,461		0.8%	245,630		1.5%
Ending Inventory			0.0%	(430,762)		-2.6%	(1,282,269)		-7.7%
Net Purchases	3,870,616		24.9%	5,590,721		33.7%	7,115,630		43.0%
Direct Mfg. Labor	2,508,059		16.1%	2,057,322		12.4%	2,008,741		12.1%
Direct Subcontract Labor	352,264		2.3%	195,743		1.2%	190,390		1.1%
Direct Overhead	60,292		0.4%	59,180		0.4%	65,175		0.4%
Allocated Costs			0.0%			0.0%			0.0%
Indirect Labor	1,984,346		12.8%	1,087,536		6.6%	1,013,935		6.1%
Shop Supplies	293,598		1.9%	244,935		1.5%	256,004		1.5%
TOTAL COST OF GOODS SOLD	9,069,175		58.3%	9,235,437		55.6%	10,649,875		64.3%
GROSS PROFIT	6,486,420		41.7%	7,366,218		44.4%	5,912,483		35.7%
OTHER INCOME (EXPENSE)									
Expedite Charge	34,274		0.2%	9,924		0.1%	1,038		0.0%
NR Charge	12,152		0.1%	3,979		0.0%	22,144		0.1%
Other Income	11,592		0.1%	54,344		0.3%	33,470		0.2%
Gain (Loss) Sale of Assets	14,685	(14,685)	0.1%	91,996	(91,996)	0.6%	76,500	(76,500)	0.5%
Purchase Discounts, Interest	23,704		0.2%	11,464		0.1%	1		0.0%
TOTAL OTHER INCOME	96,407	(14,685)	0.6%	171,707	(91,996)	1.0%	133,153	(76,500)	0.8%
Income Statement Key: os-Owner's Salary s-Wages & Salaries r-Rent tl-Taxes & Licenses a-Advertising b-Benefits/Pension rm-Repairs									
EXPENSES									
Compensation to Owner	722,956	584,956	4.6%	528,846	394,212	3.2%	503,269	371,919	3.0%
Payroll Expense	294,457		1.9%	1,088,278		6.6%	1,129,473		6.8%
Commission Expense	3,085		0.0%	20,002		0.1%	10,319		0.1%
Accrued Vacation	(176,286)		-1.1%	25,276		0.2%	77,034		0.5%
Repairs and Maintenance	137,551		0.9%	89,642		0.5%	91,121		0.6%
Bad Debts	3,239		0.0%			0.0%	525		0.0%
Rent	654,300	654,300	4.2%	439,555	439,555	2.6%	796,802	796,802	4.8%
Market Rent @\$5,000,000 Value		(345,215)	0.0%		(345,215)	0.0%		(345,215)	0.0%
Executive Expenses	0	0	0.0%	0	0	0.0%	0	0	0.0%
Payroll Taxes	455,685	23,398	2.9%	396,805	15,768	2.4%	380,695	14,877	2.3%
Pension Contribution 401K	12,889	950	0.1%	12,270	938	0.1%	10,116	844	0.1%
Advertising	2,576		0.0%	2,404		0.0%	2,810		0.0%
Donations, Gifts, Awards	3,400	3,400	0.0%	9,075	9,075	0.1%	4,665	4,665	0.0%
Sales Tax	26,658		0.2%	22,245		0.1%	18,400		0.1%
State Income Taxes	800	800	0.0%	800	800	0.0%	800	800	0.0%
Taxes, Licenses and Permits	6,925		0.0%	5,544		0.0%	5,409		0.0%
Depreciation, Amortization	344,149	344,149	2.2%	421,807	421,807	2.5%	540,400	540,400	3.3%
Property Taxes	28,901	(38,099)	0.2%	31,177	(35,823)	0.2%	50,224	(16,776)	0.3%
Interest Expense, Penalties	43,527	43,527	0.3%	53,277	53,277	0.3%	94,724	94,724	0.6%
Outside Services	1,979		0.0%	4,930		0.0%			0.0%
Auto Expense	90,228	18,046	0.6%	36,275	7,255	0.2%	33,553	6,711	0.2%
Bank and Credit Card Charges	4,312		0.0%	4,183		0.0%	3,935		0.0%
Insurance	23,385		0.2%	28,076		0.2%	21,337		0.1%
Health Insurance	341,479	9,198	2.2%	380,645	9,198	2.3%	362,845	12,029	2.2%
Workman's Comp	249,237		1.6%	207,265		1.2%	215,569		1.3%
Professional Services	528,706		3.4%	594,474		3.6%	475,103		2.9%
Office Expense, Printing	83,346		0.5%	47,430		0.3%	28,341		0.2%
Sm Computer Equipment	23,640		0.2%	29,843		0.2%	15,366		0.1%
Misc., Dues, Training	22,778		0.1%	8,614		0.1%	9,362		0.1%
Operating Expense	19,978		0.1%	11,870		0.1%	15,080		0.1%
Company Event	16,491		0.1%	22,673		0.1%			0.0%
Travel and Entertainment	46,180	18,472	0.3%	24,127	9,651	0.1%	23,881	9,552	0.1%
Employee Meals	21,235		0.1%	10,229		0.1%	12,508		0.1%
Supplies	52,695		0.3%	50,121		0.3%	37,095		0.2%
Freight & Shipping, Postage	348,971		2.2%	244,919		1.5%	463,063		2.8%
Expedite Fee (Moving Expense)	3,525		0.0%	2,667		0.0%	6,189		0.0%
Small Tool Expense			0.0%	7,099		0.0%	9,962		0.1%
Utilities	233,622		1.5%	219,726		1.3%	211,836		1.3%
TOTAL EXPENSES / Total Add-Backs	4,676,599	1,317,882	30.1%	5,082,169	980,498	30.6%	5,661,811	1,491,331	34.2%
TOTAL INCOME (per Tax Return/P&L) =	1,906,228		12.3%	2,455,756		14.8%	383,825		2.3%
Total Add Backs =		1,303,197			888,502			1,414,831	
Seller's Discretionary Earnings =		3,209,425	22.6%		3,344,258	20.1%		1,798,656	10.9%
Hypothetical Mgr.'s Cash Compensation =		(240,000)			(234,100)			(228,400)	
Manager's P/R Taxes & Benefits =		(48,000)			(46,800)			(45,700)	
Normalized EBITDA =	2,921,425		17.3%	3,063,358		18.5%	1,524,556		9.2%

HiTech Precision Sheetmetal, Inc.

Balance Sheet		Dec 31, 2014	Accrual Basis	Dec 31, 2013	Accrual Basis	Dec 31, 2012	Accrual Basis
c	Cash and Equivalent	814,074		2,770,420		416,513	
ar	Accounts Receivable	f85 2,045,025	7.6x 48 days	1,403,313	11.8x 31 days	2,772,009	6x 61 days
in	Inventory-Raw Materials	465,671		291,038		697,447	
in	Inventory-Work in Process	80,138	12.5x 29 days	85,764	21.4x 17 days	476,041	8.3x 44 days
in	Inventory-Finished Goods	179,992		53,960		108,781	
ca	Employee Receivables	80,975		88,112		79,947	
ca	Due From Shareholder	100,000					
ca	Prepays, Deposits	f91 85,048		77,988		58,864	
tca	Total Current Assets		3,850,923		4,770,595		4,609,602
ffe	Fixtures & Equipment	f93 4,678,941		k93 5,020,071		5,043,578	
fd	Depreciation	(3,070,053)		(3,011,954)		(2,787,891)	
ffi	Tenant Improvements	409,017					
ftd	TI-Depreciation	(269,404)					
oa	Lease Deposits	-		-		17,371	
ta	Total Assets		5,599,424		6,778,712		6,882,660
cl	Accruals	f99 294,495		k99 270,164		p99 302,481	
cl	Rent Payable	f100					
cl	Credit Cards	20,333		8,557			
ap	Accounts Payable	f102 682,537	13.3x 27 days	207,039	40.5x 9 days	922,278	11.5x 32 days
sd	Notes, Lines of Credit	f103 375,000		-		60,000	
tcl	Total Current Liabilities		1,372,365		485,760		1,284,759
ld	Long-Term Debt	f105 629,340		970,651		1,718,751	
ol	Deferred Taxes	10,000		10,000		10,000	
ol	Due to Shareholder	f107 984,208		984,207		p107 1,459,688	
tl	Total Liabilities		2,995,913		2,450,618		4,473,198
nw	Net Worth	f109 2,603,511		k109 4,328,094		p109 2,409,462	
tn	Total Liabilities + Net Worth		5,599,424		6,778,712		6,882,660

Balance Sheet Key: c-Cash ar-Accounts Receivable in-Inventory ca-Other Cur Assets oa-Other Long-Term Assets or Amortization ffe-Fixed Assets fd-Fixed Asset Depr. fti-Tenant Improvements ftd-Tenant Imp. Depr. ap-Accounts Payable cl-Cur Liabilities sd-Short Term IB Debt ld-Long Term IB Debt ol- Other Liabilities

S-Corporation

April 1, 2015

	Accrual Basis			Accrual Basis		
	Dec 31, 2011 12 Mos.	Add Backs Per P&Ls		Dec 31, 2010 12 Mos.	Add Backs Per P&Ls	
INCOME						
Sales	15,783,354	-	100.0%	14,757,942	-	100.0%
Freight, Design	-	-	0.0%	-	-	0.0%
TOTAL INCOME	15,783,354	-	100.0%	14,757,942	-	100.0%
COST OF GOODS SOLD						
Beginning Inventory	1,306,601	-	8.3%	1,067,158	-	7.2%
Raw Materials	5,956,093	-	37.7%	5,851,004	-	39.6%
Work-in-Process	347,239	-	2.2%	508,508	-	3.4%
Finished Goods	209,666	-	1.3%	529,101	-	3.6%
Ending Inventory	(1,370,322)	-	-8.7%	(1,306,601)	-	-8.9%
Net Purchases	6,449,277	-	40.9%	6,649,170	-	45.1%
Direct Mfg. Labor	2,471,732	-	15.7%	1,852,822	-	12.6%
Direct Subcontract Labor	68,159	-	0.4%	89,831	-	0.6%
Direct Overhead	88,628	-	0.6%	66,958	-	0.5%
Allocated Costs	u21	-	0.0%	z21	-	0.0%
Indirect Labor	773,442	-	4.9%	712,620	-	4.8%
Shop Supplies	394,923	-	2.5%	188,842	-	1.3%
TOTAL COST OF GOODS SOLD	10,246,161	-	64.9%	9,560,243	-	64.8%
GROSS PROFIT	5,537,193			5,197,699		
	35.1%			35.2%		
OTHER INCOME (EXPENSE)						
Expedite Charge	500	-	0.0%	-	-	0.0%
NR Charge	7,155	-	0.0%	-	-	0.0%
Other Income	23,202	-	0.1%	9,239	-	0.1%
Gain (Loss) Sale of Assets	u32 (54,105)	54,105	-0.3%	-	-	0.0%
Purchase Discounts, Interest	28	-	0.0%	2,077	-	0.0%
TOTAL OTHER INCOME	(23,220)	54,105	-0.1%	11,316	-	0.1%
EXPENSES						
Compensation to Owner	u36 443,250	315,103	2.8%	z36 528,846	403,825	3.6%
Payroll Expense	1,079,280	-	6.8%	697,333	-	4.7%
Commission Expense	17,514	-	0.1%	20,741	-	0.1%
Accrued Vacation	38,809	-	0.2%	13,037	-	0.1%
Repairs and Maintenance	65,326	-	0.4%	178,233	-	1.2%
Bad Debts	22,779	-	0.1%	-	-	0.0%
Rent	u42 696,634	696,634	4.4%	z42 590,779	590,779	4.0%
Market Rent @\$5,000,000 Value	-	(345,215)	0.0%	-	(345,215)	0.0%
Executive Expenses	11,702	-	0.1%	19,978	-	0.1%
Payroll Taxes	418,077	12,604	2.6%	320,645	16,153	2.2%
Pension Contribution 401K	7,045	750	0.0%	6,008	576	0.0%
Advertising	3,208	-	0.0%	3,992	-	0.0%
Donations, Gifts, Awards	u48 9,863	9,863	0.1%	z48 150	150	0.0%
Sales Tax	38,263	-	0.2%	21,616	-	0.1%
State Income Taxes	1,600	1,600	0.0%	800	800	0.0%
Taxes, Licenses and Permits	3,892	-	0.0%	4,143	-	0.0%
Depreciation, Amortization	u52 401,423	401,423	2.5%	z52 397,756	397,756	2.7%
Property Taxes	25,198	(41,802)	0.2%	27,674	(39,326)	0.2%
Interest Expense, Penalties	u54 52,008	52,008	0.3%	z54 49,960	49,960	0.3%
Outside Services	-	-	0.0%	-	-	0.0%
Auto Expense	42,172	8,434	0.3%	33,879	6,776	0.2%
Bank and Credit Card Charges	8,027	-	0.1%	8,634	-	0.1%
Insurance	44,732	-	0.3%	21,679	-	0.1%
Health Insurance	u59 289,954	13,027	1.8%	z59 242,566	5,829	1.6%
Workman's Comp	230,755	-	1.5%	149,430	-	1.0%
Professional Services	184,376	-	1.2%	233,051	-	1.6%
Office Expense, Printing	30,305	-	0.2%	35,361	-	0.2%
Sm Computer Equipment	14,449	-	0.1%	10,285	-	0.1%
Misc., Dues, Training	5,491	-	0.0%	6,380	-	0.0%
Operating Expense	16,543	-	0.1%	15,230	-	0.1%
Company Event	1,272	-	0.0%	-	-	0.0%
Travel and Entertainment	u67 14,126	5,650	0.1%	z67 15,727	6,291	0.1%
Employee Meals	11,388	-	0.1%	11,248	-	0.1%
Supplies	51,006	-	0.3%	26,069	-	0.2%
Freight & Shipping, Postage	304,224	-	1.9%	337,558	-	2.3%
Expedite Fee (Moving Expense)	11,731	-	0.1%	1,307	-	0.0%
Small Tool Expense	3,208	-	0.0%	1,476	-	0.0%
Utilities	195,042	-	1.2%	159,374	-	1.1%
TOTAL EXPENSES / Total Add-Backs	4,794,672	1,141,782	30.4%	4,190,945	1,114,331	28.4%
TOTAL INCOME (per Tax Return/P&L) =	u75 719,301		4.6%	z75 1,018,070		6.9%
Total Add Backs =		1,195,887			1,114,331	
Seller's Discretionary Earnings =		1,915,188	12.1%		2,132,401	14.4%
Hypothetical Mgr.'s Cash Compensation =		(222,800)			(217,400)	
Manager's P/R Taxes & Benefits =		(44,600)			(43,500)	
Normalized EBITDA =		1,647,788	10.4%		1,871,501	12.7%

Balance Sheet

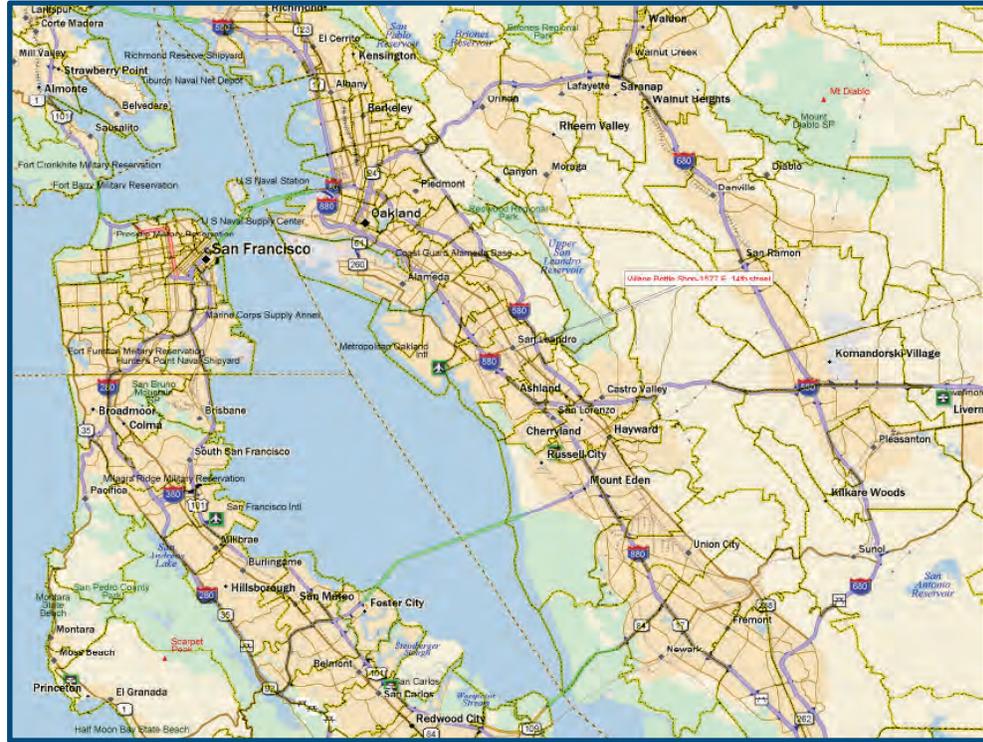
	Dec 31, 2011	Accrual Basis	Dec 31, 2010	Accrual Basis
c	Cash and Equivalent	877,929	95,942	
ar	Accounts Receivable	3,016,264	2,843,715	5.2x 70 days
in	Inventory-Raw Materials	554,419	870,996	
in	Inventory-Work in Process	606,118	255,555	7.5x 49 days
in	Inventory-Finished Goods	209,785	180,050	
ca	Employee Receivables	25,800		
ca	Due From Shareholder			
ca	Prepays, Deposits	47,533	28,091	
tca	Total Current Assets			
		5,337,848	4,274,349	
ffe	Fixtures & Equipment	5,065,839	4,304,153	
fd	Depreciation	(2,344,545)	(2,049,017)	
fdi	Tenant Improvements			
fdi	TI-Depreciation			
oa	Lease Deposits	14,971	-	
ta	Total Assets			
		8,074,113	6,529,485	
cl	Accruals	u99 194,893	208,117	
cl	Rent Payable		577,352	
cl	Credit Cards			
ap	Accounts Payable	1,813,741	993,834	5.7x 64 days
sd	Notes, Lines of Credit	395,612	798,375	9.9x 37 days
tcl	Total Current Liabilities			
		2,404,246	2,577,678	
ld	Long-Term Debt	2,208,997	688,556	
ol	Deferred Taxes	10,000	10,000	
ol	Due to Shareholder	u107 1,015,405	u107 1,230,119	
tl	Total Liabilities			
		5,638,648	4,506,353	
nw	Net Worth	u109 2,435,465	u109 2,600,484	
tl	Total Liabilities + Net Worth			
		8,074,113	7,106,837	

Analysis Removed due to Confidentiality Reasons

HiTech Precision Sheetmetal, Inc.

999 Anystreet
Silicon Valley, CA 95134

DEMOGRAPHICS



Census 1990-2012 Demographic Profile

US Census Fact Finder, 2013

California

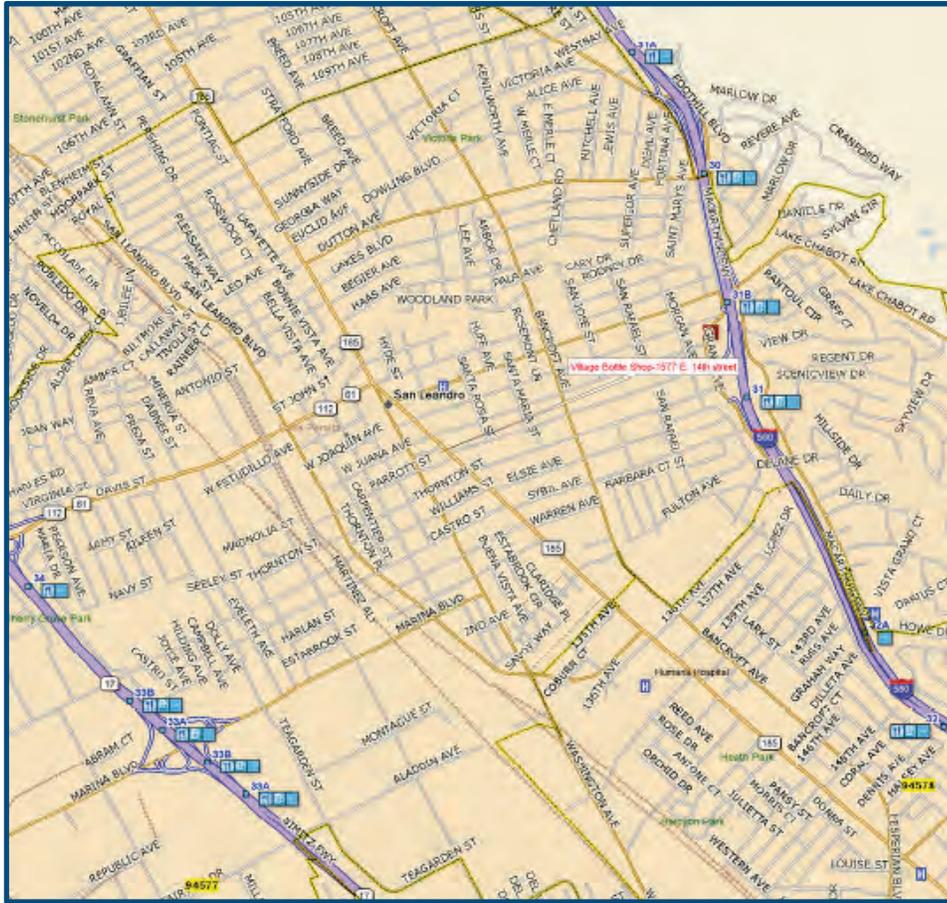
Population		Year	California	% of U.S. Population	United States	Increase from 2007 to 2013	
						California	United States
Total Population		2007	36,553,215	12.1%	301,621,000	+ 0.7% per year	+ 0.8% per year
		2013	38,041,430	12.0%	316,128,839		
Economic Characteristics							
Median Household Income		2007	59,948	118.2%	50,700		
		2013	58,328	111.6%	52,250		
Housing Characteristics							
Median Value (dollars)		2007	532,300	274.0%	194,300		
		2013	349,400	200.9%	173,900		
Unemployment Rate							
		Dec-2009	11.8%	119.2%	9.9%		
		Dec-2014	6.8%	121.4%	5.6%		

California

Population	Year	California	% of U.S. Population	United States	Increase from 2000 to 2013	
					California	United States
Total Population	2000	33,871,648	12.0%	281,421,000	+ 0.9% per year	+ 0.9% per year
Median Household Income		47,493	113.1%	41,994		
Median Value (dollars)		211,500	176.8%	119,600		

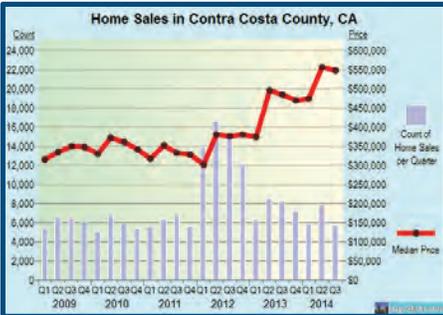
California

Population	Year	California	% of U.S. Population	United States	Increase from 1990 to 2013	
					California	United States
Total Population	1990	29,760,000	12.0%	248,710,000	+ 1.1% per year	+ 1.0% per year
Median Household Income		35,798	119.3%	30,000		
Median Value (dollars)		195,500	249.0%	78,500		



General Characteristics
 Total Population
 Economic Characteristics
 Median Household Income
 Housing Characteristics
 Median Value (dollars)
 Unemployment Rate

Santa Clara County				Santa Clara	California
1990	2000	2007	2013	2000-2007	2000-2007
1,497,000	1,686,000	1,749,000	1,862,000	+ 0.5%	0.9%
				Santa Clara vs CA	
48,100	74,300	84,400	92,000	+ 40.8%	59,948
287,700	446,000	758,100	682,300	+ 42.4%	532,300
				Santa Clara: Dec-20	Dec-2014
Dec-2009 / Dec-2014		10.8%	4.5%	11.8%	6.8%



General Characteristics
 Total Population
 Economic Characteristics
 Median Household Income
 Housing Characteristics
 Median Value (dollars)
 Unemployment Rate

Contra Costa County				Contra Costa	California
1990	2000	2007	2013	2000-2007	2000-2007
803,700	948,800	1,019,600	1,094,200	+ 1.1%	0.9%
				Contra Costa vs CA	
45,100	63,700	76,400	79,100	+ 27.4%	59,948
217,100	268,000	622,200	424,100	+ 16.9%	532,300
				Contra Costa: Dec-20	Dec-2014
Dec-2009 / Dec-2014		10.6%	5.2%	11.8%	12.3%



General Characteristics
Total Population

Economic Characteristics
Median Household Income

Housing Characteristics
Median Value (dollars)

Unemployment Rate

San Francisco County				San Francisco	California
1990	2000	2007	2013	2000-2007	2000-2007
724,000	777,000	765,000	837,400	-0.2%	0.9%
				San Francisco vs CA	CA-2007
33,400	55,200	68,000	77,500	+ 13.4%	59,948
294,800	396,000	830,700	778,000	+ 56.1%	532,300
				San Francisco: Dec-20	Dec-2014
				CA-Dec-20	CA-c-2014
Dec-2009 / Dec-2014				8.9%	3.9%
				11.8%	6.8%



General Characteristics
Total Population

Economic Characteristics
Median Household Income

Housing Characteristics
Median Value (dollars)

Unemployment Rate

San Mateo County				San Mateo	California
1990	2000	2007	2013	2000-2007	2000-2007
650,000	708,000	707,000	747,400	0.0%	0.9%
				San Mateo vs CA	CA-2007
46,400	70,800	83,100	91,300	+ 38.6%	59,948
340,800	469,000	843,100	748,300	+ 58.4%	532,300
				San Mateo: Dec-20	Dec-2014
				CA-Dec-20	CA-c-2014
Dec-2009 / Dec-2014				8.4%	3.6%
				11.8%	6.8%



General Characteristics
Total Population

Economic Characteristics
Median Household Income

Housing Characteristics
Median Value (dollars)

Unemployment Rate

Alameda County				Alameda	California
1990	2000	2007	2013	2000-2007	2000-2007
1,279,000	1,444,000	1,464,200	1,578,900	+ 0.2%	0.9%
				Alameda vs CA	CA-2007
37,500	56,000	68,740	72,400	+ 14.7%	59,948
225,300	301,100	651,800	518,900	+ 22.4%	532,300
				Alameda: Dec-20	Dec-2014
				CA-Dec-20	CA-c-2014
Dec-2009 / Dec-2014				10.4%	5.1%
				11.8%	6.8%

	U.S.	California	Santa Clara County	Contra Costa County	San Francisco County	San Mateo County	Alameda County		
Population	1990	248,710,000	29,760,000	1,497,000	803,700	724,000	650,000	1,279,000	
	2000	281,421,000	33,871,648	1,686,000	948,800	777,000	708,000	1,444,000	
	2007	301,621,000	36,553,215	1,749,000	1,019,600	765,000	707,000	1,464,200	
	2013	316,128,839	38,041,430	1,862,000	1,094,200	837,400	747,400	1,578,900	
	Gain '07 to '13	0.8% per year	0.7% per year	1.0% per year	1.2% per year	1.5% per year	0.9% per year	1.3% per year	1.2% per year
	Gain '00 to '07	1.0% per year	1.1% per year	0.5% per year	1.0% per year	-0.2% per year	0.0% per year	0.2% per year	0.4% per year
Gain '90 to '00	1.2% per year	1.3% per year	1.2% per year	1.7% per year	0.7% per year	0.9% per year	1.2% per year	1.2% per year	
Median Household Income	1990	\$30,000	\$35,798	\$48,100	\$45,100	\$33,400	\$46,400	\$37,500	\$42,505
	2000	\$41,994	\$47,493	\$74,300	\$63,700	\$55,200	\$70,800	\$56,000	\$64,630
	2007	\$50,700	\$59,948	\$84,400	\$76,400	\$68,000	\$83,100	\$68,740	\$76,591
	2013	\$52,250	\$58,328	\$92,000	\$79,100	\$77,500	\$91,300	\$72,400	\$82,567
	Gain '07 to '13	0.6% per year	-0.5% per year	1.7% per year	0.7% per year	2.6% per year	1.9% per year	1.0% per year	1.5% per year
	Gain '00 to '07	2.7% per year	3.4% per year	1.8% per year	2.6% per year	3.0% per year	2.3% per year	3.0% per year	2.5% per year
Gain '90 to '00	3.4% per year	2.9% per year	4.4% per year	3.5% per year	5.2% per year	4.3% per year	4.1% per year	4.3% per year	
Median Housing Prices	1990	\$78,500	\$195,500	\$287,700	\$217,100	\$294,800	\$340,800	\$225,300	\$268,140
	2000	\$119,600	\$211,500	\$446,000	\$268,000	\$396,000	\$469,000	\$301,100	\$373,983
	2007	\$194,300	\$532,300	\$758,100	\$622,200	\$830,700	\$843,100	\$651,800	\$726,798
	2013	\$173,900	\$349,400	\$682,300	\$424,100	\$778,000	\$748,300	\$518,900	\$615,134
	Gain '07 to '13	-10.5%	-34.4%	-10.0%	-31.8%	-6.3%	-11.2%	-20.4%	-16.2%
	Gain '00 to '07	62.5%	151.7%	70.0%	132.2%	109.8%	79.8%	116.5%	99.6%
Gain '90 to '00	52.4%	8.2%	55.0%	23.4%	34.3%	37.6%	33.6%	39.0%	
Unemployment	Dec-2009	9.9%	11.8%	10.8%	10.6%	8.9%	8.4%	10.4%	10.1%
	Dec-2014	5.6%	6.8%	4.5%	5.2%	3.9%	3.6%	5.1%	4.6%
	Change	-4.3%	-5.0%	-6.3%	-5.4%	-5.0%	-4.8%	-5.3%	-5.5%

Source: U.S. Census - <http://factfinder2.census.gov/> U.S. Bureau of Labor Statistics - <http://data.bls.gov>

PayScale Market Report

All Fab Precision Sheet Metal

Compensation Summary

This PayScale compensation report represents a snapshot of market results for the position **President and CEO** and location **San Jose, California, United States**. To ensure the most accurate report, confirm that the PayScale Job and profile details on the following page describe this position and labor market accurately.



Job Summary

Plan, direct, and coordinate operational activities at the highest level of management with the help of subordinate managers. Determine company policies and business strategies and provide overall direction of private sector organizations. Typical years experience in field of 13-20. Typically holds Bachelor's Degree. Supervisory Role: Yes. Number Supervised: 100 people. Highest Level Managed: Senior Management Level. People Management Tasks: Hire employees, Mentor and advise, Promote employees, Assign and evaluate work, Terminate employees, Review performance annually, Set pay. Total Assets Under Management: \$5,000,000 total. Signing Authority: Yes. Annual Revenue: \$17,000,000 per year. Stock Exchange Listing: Privately Held.

Answers to Compensable Factors

Ordered by matching precedence

1. PayScale Job Title: President and CEO
2. Location: San Jose-Sunnyvale-Santa Clara, California Metropolitan Area
3. Years Experience Range: 13-20
4. Annual Revenue: \$17,000,000
5. Total Assets Under Management: \$5,000,000
6. Organization Type: Company
7. Avg. Size of Competing Organizations: 100
8. Budget Managed: -Not Specified-
9. Amount Authorized: -Not Specified-
10. Skill/Specialty: Skipped
11. Certification/License: Skipped
12. Number Supervised: 100
13. Organization's Industry: Fabricated Metal Product Manufacturing
14. Typical Degree Level: Bachelor's Degree
15. Highest Level Managed: Senior Management Level
16. People Management Tasks: Hire employees, Mentor and advise, Promote employees, Assign and evaluate work, Terminate employees, Review performance annually, Set pay
17. Employer is a Government Contractor: No
18. Stock Exchange Listing: Privately Held
19. Supervisory Role: Yes
20. Signing Authority: Yes

Report Stats

Report date: **March 30, 2015**
 Effective date: **February 28, 2015**
 Algorithm version: **2015.3**
 Profiles analyzed: **1,487**
 Report rating (1 to 5): **2.4**. Pay has significant variability for this job in this labor market.

Fab Precision Sheet Metal

Compensation Summary

This PayScale compensation report represents a snapshot of market results for the position **Chief Financial Officer (CFO)** and location **San Jose, California, United States**. To ensure the most accurate report, confirm that the PayScale Job and profile details on the following page describe this position and labor market accurately.



Job Summary

Provide leadership and coordination in the administrative, business planning, accounting and budgeting efforts of the company. Prepare or direct preparation of financial statements, business activity reports, financial position forecasts, annual budgets, and/or reports required by regulatory agencies. Develop internal control policies, guidelines, and procedures for activities such as budget administration, cash and credit management, and accounting. Typical years experience in field of 13-20. Typically holds Bachelor's Degree. Supervisory Role: Yes. Number Supervised: 10 people. Highest Level Managed: Middle Management Level. People Management Tasks: Hire employees, Mentor and advise, Assign and evaluate work, Review performance annually. Total Assets Under Management: \$500,000 total. Typically manages \$100,000 per year budgets. Signing Authority: Yes. Annual Revenue: \$17,000,000 per year. Stock Exchange Listing: Privately Held.

Answers to Compensable Factors

- Ordered by matching precedence
1. PayScale Job Title: Chief Financial Officer (CFO)
 2. Location: San Jose-Sunnyvale-Santa Clara, California Metropolitan Area
 3. Years Experience Range: 13-20
 4. Total Assets Under Management: \$500,000
 5. Amount Authorized: -Not Specified-
 6. Skill/Specialty: Skipped
 7. Certification/License: Skipped
 8. Annual Revenue: \$17,000,000
 9. Organization Type: Company
 10. Budget Managed: \$100,000
 11. People Management Tasks: Hire employees, Mentor and advise, Assign and evaluate work, Review performance annually
 12. Avg. Size of Competing Organizations: 100
 13. Organization's Industry: Fabricated Metal Product Manufacturing
 14. Number Supervised: 10
 15. Typical Degree Level: Bachelor's Degree
 16. Stock Exchange Listing: Privately Held
 17. Signing Authority: Yes
 18. Employer is a Government Contractor: No
 19. Highest Level Managed: Middle Management Level
 20. Supervisory Role: Yes

Report Stats

Report date: **March 30, 2015**
 Effective date: **February 28, 2015**
 Algorithm version: **2015.3**
 Profiles analyzed: **3,935**
 Report rating (1 to 5): **3.1**. Pay is mostly consistent but has some variability for this job in this labor market. Use this report with confidence.

Comparable Listing Analysis

Please read the Appendix B following this comparables listing for detailed information on how the various databases present their information. In order to make the transactional data from each database directly comparable to each other, the following adjustments were made:

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	\$350,000	No adjustment necessary	No adjustment necessary
Inventory	<u>\$175,000</u>		
Adjusted Asset Sale Price	<u>\$525,000</u>		
(= Inventory, Fixed Assets, and Goodwill)			

III. IBA DATABASE

Selling Price:

<u>Sample Selling Price Calculation</u>		<u>SDE</u>	<u>Revenue</u>
Sale Price	\$950,000	No adjustment necessary	No adjustment necessary
Real Estate	<u>(\$500,000)</u>		
Adjusted Asset Sale Price	<u>\$450,000</u>		
(= Inventory, Fixed Assets, and Goodwill)			

Transaction Details		Comp # 1	Page 127
SIC Code: 3499 Fabricated metal products - Safe and Vault Locks			
Business Description: Metal Fabrication and Sales		NOTES:	
Source: Pratts Stats	This transaction and financial statements are in Canadian Dollars.		
Transaction Type: Asset Sale	Allocation of the Purchase Price (total amount allocated includes transaction costs): Cash and cash equivalents \$400, Accounts receivable \$1,637,195, Inventory \$2,172,570, Prepaid expenses \$59,055, Property, plant and equipment \$1,388,694, Fair value of assets acquired \$5,257,914.		
Location: ON	Hydel is a well established business and produces enclosures and other products for the electrical utility industry, from manufacturing and warehousing facilities located in Scarborough and Welland, Ontario. Hydel is the largest manufacturer of pole line hardware and meter socket enclosures in Canada, and has been in business since 1974.		
Number of Employees: 0			

Transaction Data		<u>Adjusted Asset Sale Price:</u>	
Date of Sale	7/30/2004	Market Value of Invested Capital	\$5,008,036
Days on the Market	0	Plus Employment Agreement Value	<u>N/A</u>
Asking Price	\$0	Adjusted Asset Sale Price	\$5,008,036
Adjusted Asset Sale Price	\$3,061,508		
Percent Down Payment	100%		
Terms of Deal:			
Consideration: Cash in the amount of \$5,008,036. The source of the funds was provided by internally generated cash of \$2,758,036 and a four-year term loan of \$2,250,000. Additionally, the buyer incurred transaction costs in the amount of \$249,878.			

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$11,618,361	Cash	\$400	Assumed Int-Bear Debt	\$0
SDE Calculation		Accounts Receivable	\$1,637,195	L-T Liabilities	\$247,344
Owner's Compensation	N/A	Other Current & Non-Current Assets	\$59,055	Total Liabilities	\$3,457,734
Non-Cash Charges	\$193,541	Inventory	\$2,172,570		
Operating Profit	\$308,456	Furniture Fixtures, and Equipment	\$1,388,694		
Cash Flow (SDE)	\$501,997	Intangibles	\$0	Value of Real Estate	\$0
Operating Ratios		Valuation Multiples			
Cash Flow Margin (SDE%):	4.32%	Revenue Multiplier	0.26		
Rent/Annual Sales	20.4%	Cash Flow Multiplier	6.10		
		Enterprise Multiplier	1.77		

Transaction Details		Comp # 2	
SIC Code: 3441 Fabricated metal products - Fabricated Structural Metal			
Business Description: Mfg-Metal Roofing		NOTES:	
Source: Bizcomps	No Additional Comments were Submitted		
Transaction Type: asset Sale			
Location: Jacksonville, FL			
Number of Employees: 7			

Transaction Data		<u>Adjusted Asset Sale Price:</u>	
Date of Sale	10/22/2009	Sale Price	\$1,300,000
Days on the Market	112	Inventory	<u>\$122,000</u>
Asking Price	\$1,622,000	Adjusted Asset Sale Price	\$1,422,000
Adjusted Asset Sale Price	\$1,422,000		
Percent Down Payment	31%		
Terms of Deal:			
10 Yrs			

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$3,846,000	Cash	\$0	Assumed Int-Bear Debt	\$0
Cash Flow (SDE)	\$213,000	Accounts Receivable	\$0	L-T Liabilities	\$0
		Other Current & Non-Current Assets	\$0	Total Liabilities	\$0
		Inventory	\$122,000		
		Furniture Fixtures, and Equipment	\$3,348,000		
		Intangibles	\$0	Value of Real Estate	\$0
Operating Ratios		Valuation Multiples			
Cash Flow Margin (SDE%):	5.54%	Revenue Multiplier	0.37		
Rent/Annual Sales	0.0%	Cash Flow Multiplier	6.68		
		Enterprise Multiplier	6.10		

Transaction Details

Comp # 3

SIC Code: 3443 Fabricated metal products - . Power Boilers and Heat Exchanges

Business Description: Metal Fabrication of Steel Vessels NOTES:

Source: **Pratts Stats**

Transaction Type: Asset Sale

Location:

Number of Employees: 65

No Additional Comments were Submitted

Transaction Data

Date of Sale 1/21/2006

Days on the Market 354

Asking Price \$1,350,000

Sale Price \$1,100,000

Percent Down Payment 73%

Terms of Deal:

No Terms were Submitted

Income Data

Annual Gross Sales \$5,632,127

SDE Calculation

Owner's Compensation \$105,000

Non-Cash Charges \$84,647

Operating Profit \$129,850

Cash Flow (SDE) \$319,497

Asset Data

Cash \$0

Accounts Receivable \$1,417,494

Other Current & Non-Current Assets \$0

Inventory \$354,409

Furniture Fixtures, and Equipment \$366,306

Intangibles \$0

Liability Data

Assumed Int-Bear Debt \$0

L-T Liabilities \$0

Total Liabilities \$1,352,667

Value of Real Estate \$0

Operating Ratios

Cash Flow Margin (SDE%): 5.67%

Rent/Annual Sales 30.4%

Valuation Multiples

Revenue Multiplier 0.20

Cash Flow Multiplier 3.44

Enterprise Multiplier 2.33

Transaction Details

Comp # 4

SIC Code: 3499 Fabricated metal products - . Safe and Vault Locks

Business Description: Mfg-Specialty Products NOTES:

Source: **Bizcomps**

Transaction Type: asset Sale

Location: Florida

Number of Employees: 3

No Additional Comments were Submitted

Transaction Data

Date of Sale 9/29/2006

Days on the Market 64

Asking Price \$650,000

Adjusted Asset Sale Price \$625,000

Percent Down Payment 72%

Terms of Deal:

Adjusted Asset Sale Price:

Sale Price \$620,000

Inventory \$5,000

Adjusted Asset Sale Price \$625,000

3 Yrs @ 10%

Income Data

Annual Gross Sales \$4,790,000

Cash Flow (SDE) \$300,000

Asset Data

Cash \$0

Accounts Receivable \$0

Other Current & Non-Current Assets \$0

Inventory \$5,000

Furniture Fixtures, and Equipment \$40,000

Intangibles \$0

Liability Data

Assumed Int-Bear Debt \$0

L-T Liabilities \$0

Total Liabilities \$0

Value of Real Estate \$0

Operating Ratios

Cash Flow Margin (SDE%): 6.26%

Rent/Annual Sales 0.8%

Valuation Multiples

Revenue Multiplier 0.13

Cash Flow Multiplier 2.08

Enterprise Multiplier 2.07

Transaction Details**Comp # 5**

SIC Code: 3469 Fabricated metal products - . Metal Stamping, NEC (Except Kitchen Utensil

Business Description: Metal Stamping

NOTES:

Source: **Pratts Stats**

Transaction Type: Asset Sale

Location: NV

Number of Employees: 50

Buyer defaulted on loan.

Transaction Data

Date of Sale 7/1/2005

Days on the Market 122

Asking Price \$2,500,000

Sale Price \$2,500,000

Percent Down Payment 72%

Terms of Deal:

8% with 5-year balloon.

Income Data

Annual Gross Sales \$7,387,240

SDE Calculation

Owner's Compensation \$120,000

Non-Cash Charges \$235,000

Operating Profit \$346,957

Cash Flow (SDE) \$701,957

Asset Data

Cash \$0

Accounts Receivable \$822,414

Other Current & Non-Current Assets \$108,152

Inventory \$1,384,415

Furniture Fixtures, and Equipment \$1,000,000

Intangibles \$0

Liability Data

Assumed Int-Bear Debt \$700,000

L-T Liabilities \$987,474

Total Liabilities \$1,848,898

Value of Real Estate \$0

Operating Ratios

Cash Flow Margin (SDE%): 9.5%

Rent/Annual Sales 32.1%

Valuation Multiples

Revenue Multiplier 0.34

Cash Flow Multiplier 3.56

Enterprise Multiplier 1.59

Transaction Details**Comp # 6**

SIC Code: 3499 Fabricated metal products - . Safe and Vault Locks

Business Description: Fabricated Sheet Metal Tool Boxes for Trucks and NOTES:

Source: **Pratts Stats**

Transaction Type: Asset Sale

Location: FL

Number of Employees: 32

EBT includes interest income of \$5,180.

Transaction Data

Date of Sale 6/26/2007

Days on the Market 159

Asking Price \$2,800,000

Adjusted Asset Sale Price \$1,762,398

Percent Down Payment 35%

Terms of Deal:

Adjusted Asset Sale Price:

Market Value of Invested Capital \$1,424,398

Plus Employment Agreement Value \$338,000

Adjusted Asset Sale Price \$1,762,398

Consideration: 9% interest over the first year and 7% over the next 6 years.

Income Data

Annual Gross Sales \$3,089,670

SDE Calculation

Owner's Compensation \$142,900

Non-Cash Charges \$31,933

Operating Profit \$127,270

Cash Flow (SDE) \$302,103

Asset Data

Cash \$31,754

Accounts Receivable \$213,585

Other Current & Non-Current Assets \$34,001

Inventory \$478,328

Furniture Fixtures, and Equipment \$82,422

Intangibles \$0

Liability Data

Assumed Int-Bear Debt \$100,028

L-T Liabilities \$20,430

Total Liabilities \$439,091

Value of Real Estate \$0

Operating Ratios

Cash Flow Margin (SDE%): 9.78%

Rent/Annual Sales 32.6%

Valuation Multiples

Revenue Multiplier 0.57

Cash Flow Multiplier 5.83

Enterprise Multiplier 4.25

Transaction Details		Comp # 7	Page 130
SIC Code: 3441 Fabricated metal products - Fabricated Structural Metal			
Business Description: Manufactures Flue Gas Dampers and Expansion J NOTES:			
Source:	Pratts Stats	EBT includes interest income of \$17,155 and loss on disposal of property of (\$3,054).	
Transaction Type:	Asset Sale	Allocation of the Purchase Price: Current assets \$8,261,000, Property and equipment \$278,000, Intangible assets – finite life \$231,000, Goodwill \$3,910,000, Other assets \$129,000, Total assets acquired \$12,809,000, current liabilities assumed (\$4,756,000), Other liabilities assumed (\$1,048,000), Net assets acquired \$7,005,000.	
Location:	OH	Effox, located in Cincinnati, Ohio, engineers and manufactures dampers and expansion joints for use in flue gas and process air handling systems and is a provider of equipment to the power industry. Effox also provides design, rebuilding and repair services for a variety of existing industrial systems.	
Number of Employees:	0		

Transaction Data		<u>Adjusted Asset Sale Price:</u>	
Date of Sale	2/28/2007	Market Value of Invested Capital	\$7,005,000
Days on the Market	0	Plus Employment Agreement Value	N/A
Asking Price	\$0	Adjusted Asset Sale Price	\$7,005,000
Adjusted Asset Sale Price	\$7,005,000		
Percent Down Payment	100%		
Terms of Deal:			
Consideration: Cash in the amount of \$7,005,000. Additionally, the former owners of Effox are entitled to earn-out payments of up to \$1,000,000 in the aggregate upon the attainment of specified gross profit amounts through December 31, 2009.			

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$28,639,549	Cash	\$2,195,867	Assumed Int-Bear Debt	N/A
SDE Calculation		Accounts Receivable	\$6,480,138	L-T Liabilities	\$5,141,684
Owner's Compensation	N/A	Other Current & Non-Current Assets	\$1,128,657	Total Liabilities	#####
Non-Cash Charges	\$169,208	Inventory	\$2,172,055		
Operating Profit	\$2,650,742	Furniture Fixtures, and Equipment	\$292,377		
Cash Flow (SDE)	\$2,819,950	Intangibles	\$0	Value of Real Estate	\$0
Operating Ratios		Valuation Multiples			
Cash Flow Margin (SDE%):	9.85%	Revenue Multiplier	0.24		
Rent/Annual Sales	26.3%	Cash Flow Multiplier	2.48		
		Enterprise Multiplier	1.71		

Transaction Details		Comp # 8
SIC Code: 3499 Fabricated metal products - . Safe and Vault Locks		
Business Description: Mfg-Metal Products NOTES:		
Source:	Bizcomps	No Additional Comments were Submitted
Transaction Type:	asset Sale	
Location:	Florida	
Number of Employees:	8	

Transaction Data		<u>Adjusted Asset Sale Price:</u>	
Date of Sale	10/22/2009	Sale Price	\$592,000
Days on the Market	0	Inventory	\$100,000
Asking Price	\$870,000	Adjusted Asset Sale Price	\$692,000
Adjusted Asset Sale Price	\$692,000		
Percent Down Payment	30%		
Terms of Deal:			
10 Yrs @ 8%			

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$3,878,000	Cash	\$0	Assumed Int-Bear Debt	\$0
Cash Flow (SDE)	\$406,000	Accounts Receivable	\$0	L-T Liabilities	\$0
		Other Current & Non-Current Assets	\$0	Total Liabilities	\$0
		Inventory	\$100,000		
		Furniture Fixtures, and Equipment	\$348,000		
		Intangibles	\$0	Value of Real Estate	\$0
Operating Ratios		Valuation Multiples			
Cash Flow Margin (SDE%):	10.47%	Revenue Multiplier	0.18		
Rent/Annual Sales	1.2%	Cash Flow Multiplier	1.70		
		Enterprise Multiplier	1.46		

Transaction Details		Comp # 9	Page 131
SIC Code: 3499 Fabricated metal products - Safe and Vault Locks			
Business Description: Mfg-Metal Fabrication		NOTES:	
Source: Bizcomps	No Additional Comments were Submitted		
Transaction Type: asset Sale			
Location: Virginia			
Number of Employees: 16			

Transaction Data		<u>Adjusted Asset Sale Price:</u>
Date of Sale	5/1/2010	Sale Price \$900,000
Days on the Market	584	Inventory <u>\$40,000</u>
Asking Price	\$940,000	Adjusted Asset Sale Price \$940,000
Adjusted Asset Sale Price	\$940,000	
Percent Down Payment	100%	
Terms of Deal:		
No Terms were Submitted		

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$3,705,000	Cash	\$0	Assumed Int-Bear Debt	\$0
Cash Flow (SDE)	\$404,000	Accounts Receivable	\$0	L-T Liabilities	\$0
		Other Current & Non-Current Assets	\$0	Total Liabilities	\$0
		Inventory	\$40,000		
		Furniture Fixtures, and Equipment	\$309,000		
		Intangibles	\$0	Value of Real Estate	\$0
Operating Ratios			Valuation Multiples		
Cash Flow Margin (SDE%):	10.9%	Revenue Multiplier	0.25		
Rent/Annual Sales	3.6%	Cash Flow Multiplier	2.33		
		Enterprise Multiplier	2.23		

Transaction Details		Comp # 10
SIC Code: 3448 Fabricated metal products - Prefabricated Metal Buildings and Components		
Business Description: Manufacture and Distributor of Steel Framed Canc NOTES:		
Source: Pratts Stats	Canadian Dollars	
Transaction Type: Asset Sale		
Location: QC		
Number of Employees: 30		

Transaction Data	
Date of Sale	8/23/2010
Days on the Market	172
Asking Price	\$0
Sale Price	\$3,431,341
Percent Down Payment	79%
Terms of Deal:	
Two equal annual payments on the closing anniversary at 6%	

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$6,291,996	Cash	\$52,726	Assumed Int-Bear Debt	\$0
SDE Calculation		Accounts Receivable	\$2,139,326	L-T Liabilities	\$3,036,569
Owner's Compensation	\$0	Other Current & Non-Current Assets	\$45,785	Total Liabilities	\$3,823,428
Non-Cash Charges	\$96,394	Inventory	\$815,796		
Operating Profit	<u>\$659,507</u>	Furniture Fixtures, and Equipment	\$378,906		
Cash Flow (SDE)	\$755,901	Intangibles	\$0	Value of Real Estate	\$1,050,207
Operating Ratios			Valuation Multiples		
Cash Flow Margin (SDE%):	12.01%	Revenue Multiplier	0.55		
Rent/Annual Sales	31.9%	Cash Flow Multiplier	4.54		
		Enterprise Multiplier	3.46		

Transaction Details		Comp # 11	Page 132
SIC Code: 3444 Fabricated metal products - Sheet Metal Work		NOTES:	
Business Description: Mfg-Metal Fabrication			
Source: Bizcomps	No Additional Comments were Submitted		
Transaction Type: asset Sale			
Location: Florida			
Number of Employees: 29			

Transaction Data		<u>Adjusted Asset Sale Price:</u>
Date of Sale	6/26/2007	Sale Price \$1,237,000
Days on the Market	270	Inventory <u>\$425,000</u>
Asking Price	\$2,700,000	Adjusted Asset Sale Price \$1,662,000
Adjusted Asset Sale Price	\$1,662,000	
Percent Down Payment	100%	
Terms of Deal:		
No Terms were Submitted		

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$3,443,000	Cash	\$0	Assumed Int-Bear Debt	\$0
Cash Flow (SDE)	\$417,000	Accounts Receivable	\$0	L-T Liabilities	\$0
		Other Current & Non-Current Assets	\$0	Total Liabilities	\$0
		Inventory	\$425,000		
		Furniture Fixtures, and Equipment	\$595,000		
		Intangibles	\$0	Value of Real Estate	\$0
Operating Ratios		Valuation Multiples			
Cash Flow Margin (SDE%):	12.11%	Revenue Multiplier	0.48		
Rent/Annual Sales	0.0%	Cash Flow Multiplier	3.99		
		Enterprise Multiplier	2.97		

Transaction Details		Comp # 12	
SIC Code: 3499 Fabricated metal products - . Safe and Vault Locks		NOTES:	
Business Description: Fabrication			
Source: Pratts Stats	Transaction was submitted by the GABB (3/2009). The real estate value of \$820,000 was subtracted from the selling price.		
Transaction Type: Asset Sale			
Location: GA			
Number of Employees: 23			

Transaction Data		<u>Adjusted Asset Sale Price:</u>
Date of Sale	8/6/2008	Market Value of Invested Capital \$1,323,223
Days on the Market	319	Plus Employment Agreement Value <u>N/A</u>
Asking Price	\$1,500,000	Adjusted Asset Sale Price \$1,323,223
Adjusted Asset Sale Price	\$1,323,223	
Percent Down Payment	100%	
Terms of Deal:		
No Terms were Submitted		

Income Data		Asset Data is **Allocation**		Liability Data	
Annual Gross Sales	\$4,998,000	Cash	N/A	Assumed Int-Bear Debt	\$0
SDE Calculation		Accounts Receivable	N/A	L-T Liabilities	N/A
Owner's Compensation	\$486,000	Other Current & Non-Current Assets	\$103,000	Total Liabilities Assumed	N/A
Non-Cash Charges	\$0	Inventory	\$18,000		
Operating Profit	<u>\$198,000</u>	Furniture Fixtures, and Equipment	\$412,000		
Cash Flow (SDE)	\$684,000	Intangibles	\$790,223	Value of Real Estate	\$820,000
Operating Ratios		Valuation Multiples			
Cash Flow Margin (SDE%):	13.69%	Revenue Multiplier	0.26		
Rent/Annual Sales	26.1%	Cash Flow Multiplier	1.93		
		Enterprise Multiplier	1.91		

Transaction Details		Comp # 13	Page 133
SIC Code: 3441 Fabricated metal products - Fabricated Structural Metal			
Business Description: Metal Fabricator			
Source: Pratts Stats		NOTES:	
Transaction Type: Asset Sale		No real estate transacted in this acquisition. EBT includes interest income of \$2,508, other income of \$138,415, gain on sale of property and equipment of \$6,131, and other expense of (\$20).	
Location: OR			
Number of Employees: 65			

Transaction Data		<u>Adjusted Asset Sale Price:</u>
Date of Sale	10/31/2005	Market Value of Invested Capital \$10,500,000
Days on the Market	427	Plus Employment Agreement Value <u>N/A</u>
Asking Price	\$0	Adjusted Asset Sale Price \$10,500,000
Adjusted Asset Sale Price	\$10,500,000	
Percent Down Payment	100%	
Terms of Deal:		
Consideration: Cash in the amount of \$10,500,000.		

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$15,232,287	Cash	\$831,608	Assumed Int-Bear Debt	\$0
SDE Calculation		Accounts Receivable	\$2,151,698	L-T Liabilities	\$1,116,622
Owner's Compensation	N/A	Other Current & Non-Current Assets	\$808,886	Total Liabilities	\$2,755,005
Non-Cash Charges	\$143,238	Inventory	\$362,316		
Operating Profit	<u>\$2,195,896</u>	Furniture Fixtures, and Equipment	\$2,544,625		
Cash Flow (SDE)	<u>\$2,339,134</u>	Intangibles	\$0	Value of Real Estate	\$357,633
Operating Ratios		Valuation Multiples			
Cash Flow Margin (SDE%):	15.36%	Revenue Multiplier	0.69		
Rent/Annual Sales	29.5%	Cash Flow Multiplier	4.49		
		Enterprise Multiplier	4.33		

Transaction Details		Comp # 14
SIC Code: 3489 Fabricated metal products - Ordnance and Accessories, NEC		
Business Description: Full-service Computer Numeric Controlled (CNC) NOTES:		
Source: Pratts Stats		The seller serves the aerospace, defense, and small arms industries.
Transaction Type: Asset Sale		
Location: FL		
Number of Employees: 90		

Transaction Data		<u>Adjusted Asset Sale Price:</u>
Date of Sale	1/16/2004	Market Value of Invested Capital \$4,235,631
Days on the Market	345	Plus Employment Agreement Value <u>\$200,000</u>
Asking Price	\$5,200,000	Adjusted Asset Sale Price \$4,435,631
Adjusted Asset Sale Price	\$4,435,631	
Percent Down Payment	100%	
Terms of Deal:		
No Terms were Submitted		

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$8,491,331	Cash	\$9,068	Assumed Int-Bear Debt	\$0
SDE Calculation		Accounts Receivable	\$1,081,415	L-T Liabilities	\$0
Owner's Compensation	\$200,000	Other Current & Non-Current Assets	\$864,979	Total Liabilities	\$1,050,369
Non-Cash Charges	\$0	Inventory	\$1,062,440		
Operating Profit	<u>\$1,144,932</u>	Furniture Fixtures, and Equipment	\$639,129		
Cash Flow (SDE)	<u>\$1,344,932</u>	Intangibles	\$0	Value of Real Estate	\$0
Operating Ratios		Valuation Multiples			
Cash Flow Margin (SDE%):	15.84%	Revenue Multiplier	0.52		
Rent/Annual Sales	21.7%	Cash Flow Multiplier	3.30		
		Enterprise Multiplier	2.51		

SIC Code: 3444 Fabricated metal products - Sheet Metal Work

Business Description: Mfg-Metal Fabrication

NOTES:

Source: **Bizcomps**
 Transaction Type: asset Sale
 Location: Ohio
 Number of Employees: 17

No Additional Comments were Submitted

Transaction Data

Date of Sale 6/23/2010
 Days on the Market 602
 Asking Price \$1,100,000
 Adjusted Asset Sale Price \$1,050,000
 Percent Down Payment 0%
 Terms of Deal:

Adjusted Asset Sale Price:

Sale Price \$971,000
 Inventory \$79,000
 Adjusted Asset Sale Price \$1,050,000

No Terms were Submitted

Income Data

Annual Gross Sales \$4,305,000
 Cash Flow (SDE) \$686,000

Asset Data

Cash \$0
 Accounts Receivable \$0
 Other Current & Non-Current Assets \$0
 Inventory \$79,000
 Furniture Fixtures, and Equipment \$83,000
 Intangibles \$0

Liability Data

Assumed Int-Bear Debt \$0
 L-T Liabilities \$0
 Total Liabilities \$0
 Value of Real Estate \$0

Operating Ratios

Cash Flow Margin (SDE%): 15.93%
 Rent/Annual Sales 0.0%

Valuation Multiples

Revenue Multiplier 0.24
 Cash Flow Multiplier 1.53
 Enterprise Multiplier 1.42

Transaction Details **Comp # 16**

SIC Code: 3499 Fabricated metal products - . Safe and Vault Locks

Business Description: Manufacturer of Large Industrial Steel/Metal Comp NOTES:

Source: **Pratts Stats**
 Transaction Type: Asset Sale
 Location: WA
 Number of Employees: 22

No Additional Comments were Submitted

Transaction Data

Date of Sale 6/30/2005
 Days on the Market 717
 Asking Price \$3,400,000
 Sale Price \$3,260,700
 Percent Down Payment 15%
 Terms of Deal:

No Terms were Submitted

Income Data

Annual Gross Sales \$4,284,000
 SDE Calculation
 Owner's Compensation \$48,000
 Non-Cash Charges \$37,400
 Operating Profit \$604,300
 Cash Flow (SDE) \$689,700

Asset Data is **Allocation**

Cash \$0
 Accounts Receivable \$0
 Other Current & Non-Current Assets \$10,000
 Inventory \$130,000
 Furniture Fixtures, and Equipment \$1,200,000
 Intangibles \$1,900,000

Liability Data

Assumed Int-Bear Debt \$10,700
 L-T Liabilities N/A
 Total Liabilities Assumed N/A
 Value of Real Estate \$0

Operating Ratios

Cash Flow Margin (SDE%): 16.1%
 Rent/Annual Sales 33.4%

Valuation Multiples

Revenue Multiplier 0.76
 Cash Flow Multiplier 4.73
 Enterprise Multiplier 4.54

Transaction Details		Comp # 17	Page 135
SIC Code: 3499 Fabricated metal products - . Safe and Vault Locks		NOTES:	
Business Description: Mfg-Steel Containers			
Source: Bizcomps	No Additional Comments were Submitted		
Transaction Type: asset Sale			
Location: Pennsylvania			
Number of Employees: 18			

Transaction Data		<u>Adjusted Asset Sale Price:</u>
Date of Sale	11/30/2011	Sale Price \$1,625,000
Days on the Market	0	Inventory <u>\$175,000</u>
Asking Price	\$1,900,000	Adjusted Asset Sale Price \$1,800,000
Adjusted Asset Sale Price	\$1,800,000	
Percent Down Payment	77%	
Terms of Deal:		
No Terms were Submitted		

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$3,098,000	Cash	\$0	Assumed Int-Bear Debt	\$0
Cash Flow (SDE)	\$512,000	Accounts Receivable	\$0	L-T Liabilities	\$0
		Other Current & Non-Current Assets	\$0	Total Liabilities	\$0
		Inventory	\$175,000		
		Furniture Fixtures, and Equipment	\$310,000		
		Intangibles	\$0	Value of Real Estate	\$0
Operating Ratios		Valuation Multiples			
Cash Flow Margin (SDE%):	16.53%	Revenue Multiplier	0.58		
Rent/Annual Sales	0.0%	Cash Flow Multiplier	3.52		
		Enterprise Multiplier	3.17		

Transaction Details		Comp # 18	
SIC Code: 3499 Fabricated metal products - . Safe and Vault Locks		NOTES:	
Business Description: Mfg-Metal Products			
Source: Bizcomps	No Additional Comments were Submitted		
Transaction Type: asset Sale			
Location: Georgia			
Number of Employees: 44			

Transaction Data		<u>Adjusted Asset Sale Price:</u>
Date of Sale	5/3/2006	Sale Price \$1,690,000
Days on the Market	223	Inventory <u>\$650,000</u>
Asking Price	\$3,000,000	Adjusted Asset Sale Price \$2,340,000
Adjusted Asset Sale Price	\$2,340,000	
Percent Down Payment	0%	
Terms of Deal:		
No Terms were Submitted		

Income Data		Asset Data		Liability Data	
Annual Gross Sales	\$4,998,000	Cash	\$0	Assumed Int-Bear Debt	\$0
Cash Flow (SDE)	\$936,000	Accounts Receivable	\$0	L-T Liabilities	\$0
		Other Current & Non-Current Assets	\$0	Total Liabilities	\$0
		Inventory	\$650,000		
		Furniture Fixtures, and Equipment	\$1,500,000		
		Intangibles	\$0	Value of Real Estate	\$0
Operating Ratios		Valuation Multiples			
Cash Flow Margin (SDE%):	18.73%	Revenue Multiplier	0.47		
Rent/Annual Sales	0.0%	Cash Flow Multiplier	2.50		
		Enterprise Multiplier	1.81		

SIC Code: 3499 Fabricated metal products - Safe and Vault Locks

Business Description: Mfg-Heating Impeders

Source: **Bizcomps**
 Transaction Type: asset Sale
 Location: Washington
 Number of Employees: 22

No Additional Comments were Submitted

Transaction Data

Date of Sale 3/8/2012
 Days on the Market 730
 Asking Price \$3,000,000
 Adjusted Asset Sale Price \$3,000,000
 Percent Down Payment 57%

Adjusted Asset Sale Price:

Sale Price \$2,650,000
 Inventory \$350,000
 Adjusted Asset Sale Price \$3,000,000

Terms of Deal:

5 Yrs @ 5%

Income Data

Annual Gross Sales \$4,541,000
 Cash Flow (SDE) \$980,000

Asset Data

Cash \$0
 Accounts Receivable \$0
 Other Current & Non-Current Assets \$0
 Inventory \$350,000
 Furniture Fixtures, and Equipment \$100,000
 Intangibles \$0

Liability Data

Assumed Int-Bear Debt \$0
 L-T Liabilities \$0
 Total Liabilities \$0
 Value of Real Estate \$0

Operating Ratios

Cash Flow Margin (SDE%): 21.58%
 Rent/Annual Sales 2.0%

Valuation Multiples

Revenue Multiplier 0.66
 Cash Flow Multiplier 3.06
 Enterprise Multiplier 2.70

Transaction Details **Comp # 20**

SIC Code: 3441 Fabricated metal products - Fabricated Structural Metal

Business Description: Mfg-Metal Fabrication

Source: **Bizcomps**
 Transaction Type: asset Sale
 Location: Ohio
 Number of Employees: 115

No Additional Comments were Submitted

Transaction Data

Date of Sale 10/7/2006
 Days on the Market 187
 Asking Price \$14,932,000
 Adjusted Asset Sale Price \$10,185,000
 Percent Down Payment 81%

Adjusted Asset Sale Price:

Sale Price \$8,719,000
 Inventory \$1,466,000
 Adjusted Asset Sale Price \$10,185,000

Terms of Deal:

5 Yrs @ 7%

Income Data

Annual Gross Sales \$16,868,000
 Cash Flow (SDE) \$4,297,000

Asset Data

Cash \$0
 Accounts Receivable \$0
 Other Current & Non-Current Assets \$0
 Inventory \$1,466,000
 Furniture Fixtures, and Equipment \$2,900,000
 Intangibles \$0

Liability Data

Assumed Int-Bear Debt \$0
 L-T Liabilities \$0
 Total Liabilities \$0
 Value of Real Estate \$0

Operating Ratios

Cash Flow Margin (SDE%): 25.47%
 Rent/Annual Sales 2.4%

Valuation Multiples

Revenue Multiplier 0.60
 Cash Flow Multiplier 2.37
 Enterprise Multiplier 2.03

APPENDIX B

Analysis of Transactional Databases

The Appraiser uses three databases to obtain transactional data: Bizcomps, Pratt's Stats, and the Institute of Business Appraisers (IBA) Database.¹ Each database assembles transactional data somewhat differently than the others. Therefore, it is necessary to make various adjustments to the data points in each to make them reasonably comparable to each other. The appropriate adjustments were developed from information presented in: ValuSource's and IBA's on-line help screens for the IBA database; the Business Valuation Resources on-line help screens and procedural manuals for the Pratt's Stats and Bizcomps databases; Nancy Fannon's book on how to use the databases² or, more importantly, from direct observations by the Appraiser.

1.0 Selling Price (Asset Sale)

The sales of most small businesses are structured in a manner whereby 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 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 that we will use in our analysis to reflect the selling price for just those three assets. As a result, the selling prices of all the selected transactions will be directly comparable to each other.

As we shall see 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. *In order to calculate a selling price for each database that will align with each other, we will 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 may be necessary. However, appraisers must use their best judgment to determine if the lack of data precludes obtaining a good estimate of an Asset Sale selling price. If so, they must reject that comparable.

Pratt's Stats

As noted in Nancy Fannon's book,³ Pratt's Stats indicates that, "Price is generally considered to be the dollar value consideration [note: consideration can be in the form of cash, notes, and/or securities⁴] paid for the business sold including interest-bearing debt. Therefore, the only price reported by the Pratt's Stats database is an invested capital price (which the

¹ Bizcomps® and Pratt's Stats® data are obtained from Business Valuation Resources website - www.bvmarketdata.com, and IBA data is obtained from ValuSource website - www.vswebapp.com, or the Institute of Business Appraisers (IBA) website - www.go-iba.org.

² Nancy Fannon & Heidi Walker, "The Comprehensive Guide to the Use and Application of the Transaction Databases," 2009 Edition, Business Valuation Resources, LLC

³ Ibid., p.2-3

⁴ Pratt's Stats FAQs, "Definitions: What is the Legend for Pratt's Stats Income Data," from the Business Valuation Resources website, <http://www.bvmarketdata.com>, p.3

database refers to as MVIC or Market Value of Invested Capital).” Ms. Fannon also notes that Pratt’s Stats FAQs (Frequently Asked Questions) indicated 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.⁵ In most cases when an Asset Sale also included cash or receivables, it was noted in the Additional Transaction Information in the transaction report. However, if the submitting broker neglected to mention it, the reported selling price may not be correct. The Appraiser has found instances of this error, but they are fairly uncommon.

Thus with the data available, a typical Asset Sale reported in Pratt’s Stats can usually be reconstructed to produce the total value allocated to inventory, FF&E, and intangibles. However, appraisers must read the notes appended to each transaction to confirm what other assets may have been transferred. It is not uncommon that accurate information was not provided by the submitting brokers; thus appraisers must use their judgment as to whether the comparable should or should not be used.

The selling price allocation reported in each transaction may indicate that a portion of the price included covenant-not-to-compete value, consulting agreement value, or earn-out value.⁶ Pratt’s Stats deducts the portion of the selling price allocated to consulting agreements and earn-outs in its MVIC calculation.⁷ As we shall see later Bizcomps and IBA only exclude earn-out value from their reported selling prices.

Suggested Adjustment: Thus in order to reconcile Pratt’s Stats’ MVIC to obtain the value of inventory, FF&E, and intangibles that will generally align with Bizcomps and IBA values, we must deduct from MVIC any cash, receivables, or non-operating assets that may have been included in the selling price and add back any value allocated to consulting agreements.

Actual observations by the Appraiser find this reconciliation is usually comparable to the other databases’ adjusted values. However, one must carefully review that data. 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

“The Bizcomps transactions are all Asset Sales or have been converted to Asset Sales. As such the price includes FF&E and goodwill or the intangible value. ... Bizcomps maintains that their sales prices exclude inventory ... [and] non-compete and consulting agreements are included.”⁸

⁵ Pratt’s Stats FAQs, “Definitions: What is the Legend for Pratt’s Stats Income Data,” from the Business Valuation Resources website, <http://www.bvmarketdata.com>, p.2-5.

⁶ Earn-outs 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.

⁷ Ibid., p.2-3f.

⁸ Ibid., p.3-3f.

Suggested Adjustment: Thus in order to reconcile Bizcomps' selling price that will generally align with Pratt's Stats and IBA's adjusted selling price for inventory, FF&E, and intangibles, we must 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 covenant-not-to-compete.⁹ The Market Analysis Tutorial screen on the IBA website also indicates that the selling price includes consulting agreement value.¹⁰

Although IBA claims that it excludes real estate value from the selling price, the analysis below found that of the 42 transactions in which real estate was also transferred, 27 transactions had the real estate value added to 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, in which case subtracting the real estate value produced a much more reasonable result. Therefore in transactions involving real estate, appraisers must look at the data and adjust the selling price if it appears necessary. If unsure, the transaction should be excluded from the analysis. However, as shown in Paragraph 4.1 below, over 95% of the time IBA's adjusted selling price and Bizcomp's adjusted selling price were the same.

Suggested Adjustment: Therefore, other than a possible adjustment for real estate, there are no additional adjustments necessary to reconcile IBA's selling price to align with Pratt's Stats and Bizcomps adjusted values for inventory, FF&E, and intangibles.

2.0 Revenue

Suggested Adjustment: As will be demonstrated below, all three databases appear to report revenues in the same manner, so no additional adjustments are needed.

3.0 Seller's Discretionary Earnings (SDE)

Pratt's Stats

"Pratt's Stats calculations of EBIT (Earnings before Interest and Taxes), and EBITDA (Earnings before Interest, Taxes, Depreciation, and Amortization) 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."¹¹ Owner's Compensation is the

⁹ 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)

¹⁰ Market Analysis Tutorial #3 on IBA website, "IBA Transactional Database Fundamentals," <http://go-iba.org/market-data/tutorials/index.html>, 2009, p.1

¹¹ Nancy Fannon & Heidi Walker, "The Comprehensive Guide to the Use and Application of the Transaction Databases," 2009 Edition, Business Valuation Resources, LLC, p.2-8

wage paid to one owner.¹² Three data fields from the Pratt's Stats transaction report typically will add up to Discretionary Earnings (SDE). Those data fields are Owner's Compensation, Operating Profit (EBIT), and Noncash Charges (Operating Profit plus Noncash Charges equals EBITDA). In nearly 75% of the transactions in the research discussed below, this calculation matched the SDE calculations of IBA and Bizcomps. Of the remaining 25% where the SDE's differed, over half were due to errors in processing the data by one or the other databases. Less than 10% of all the transactions had discrepancies that were 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 differences in SDE found among the databases that were procedural in nature were fairly small. Regardless, in our research below, the discrepancies resulted in the Pratt's Stats SDE value averaging 98.2% of the IBA and Bizcomps value. In other words, the discrepancies do not appear significant enough or frequent enough to adversely skew the results of our 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, the Pratt's Stats analysts can sometimes spot calculation errors that were made in the submitted data. Thus many of the discrepancies are not from procedural differences, but rather computational errors by the other databases. Since all three databases are exposed to poor data reporting by submitting brokers, it is important that appraisers carefully review each transaction to determine if it is reasonable. However, in the event that a selected sample of comparables has duplicate transactions with different values for selling price, revenues, or SDE, the data from Pratt's Stats will be used in the analysis. If in the appraiser's judgment the transactional data does not appear reliable, it should be excluded from the sample of comparables selected.

Suggested Adjustment: Thus to reconcile Seller's Discretionary Earnings from Pratt's Stats data in a manner that will generally align with IBA and Bizcomps values, we must 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 non-business or non-recurring expenses. If there is more than one owner, a hypothetical salary for the lowest paid partner will be deducted from cash flow.¹³ Bizcomps points out that this is the convention used by Certified Business Intermediaries (CBI) with the International Business Brokers Association (IBBA). The Bizcomps data is submitted almost exclusively by this group.¹⁴ The description is fairly similar to the Pratt's Stats construction with the exception that Pratt's Stats cited 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

¹² Pratt's Stats FAQs, "Definitions: What is the Legend for Pratt's Stats Income Data," from the Business Valuation Resources website, <http://www.bvmarketdata.com>. p.2

¹³ Jack Sanders, "Bizcomps 2011 User Guide," Business Valuation Resources, 2011. P.16

¹⁴ Ibid., p.7

pointed out in the research below, the procedural differences occur infrequently and are generally small.

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

IBA

If one excludes discrepancies caused by obvious computation errors, Bizcomps and IBA presented the same value for SDE 98% of the time.

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

4.0 Stock Sales

IBA

Although all transactions reported in the IBA database are supposed to be assets sales,¹⁵ there are a few transactions that are listed as Stock Sales. Of the 880 IBA transactions in the research below, only three were listed as Stock Sales. None of those were duplicates of transactions in the other databases so it is not known how IBA presents transactional data on Stock Sales. None of the help screen information on the ValuSource or IBA websites or conversations on the subject with Dave Miles of ValuSource offered any clarification.

Suggested Adjustment: Any transaction that is 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 all Stock Sale prices have been converted to this value.

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

¹⁵ 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.)

Pratt's Stats

Pratt's Stats reports both Asset Sales and Stock Sales and generally provides a significant amount of 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."¹⁶ 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. As such an 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 make the Pratt's Stats selling price align with those of IBA and Bizcomps, we added 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 in Paragraph 1.0 above.

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 was not able to definitively determine if any interest-bearing debt was assumed. If no other information is available, it may be necessary to reject this comparable. 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.¹⁷ It is also necessary to identify all the non-interest bearing debt that was also assumed. This information is generally only made 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 specific allocation information is not available in the Additional Information section or the Asset Data field is not marked "Data is a Purchase Price Allocation", 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 have established what the total asset value of the

¹⁶ Pratt's Stats FAQs, "Definitions: What is Typically Assumed to Be Transferred in a Stock Sale," from the Business Valuation Resources website, <http://www.bymarketdata.com>, p.9

¹⁷ Nancy Fannon & Heidi Walker, "The Comprehensive Guide to the Use and Application of the Transaction Databases," 2009 Edition, Business Valuation Resources, LLC, p.2-3

transferred business is, it is a simple task to subtract the value of all the assets acquired except for inventory, FF&E, and intangibles. The resulting value will be an equivalent Asset Sale value (inventory, FF&E, and intangibles) that will generally align with the selling prices in IBA and Bizcomps.

Suggested Adjustments: The following is the formula that will be used to reconcile a Stock Sale value to an equivalent Asset Sale value. An actual sample transaction from Pratt's Stats follows the 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 Date field is marked "Data is a Purchase Price Allocation."

MVIC (Cash, Stock, Notes, IB debt Assumed)	*14,021,000
Plus Additional Non-Interest Bearing Debt	625,000
Plus Employment/consulting Agreement	-0-
Less Cash	(0)
Less Accounts Receivable	(856,000)
Less Other Assets (prepaids & for-sale assets)	<u>(1,572,000)</u>
Asset Sale Value Equivalent	\$12,218,000

*Note: Pratt's Stats incorrectly added up Total Consideration. It should have been \$13,994,000. That would have made the Asset Sale Value equal to \$12,191,000 which is the actual total for inventory, FF&E, and goodwill.

Pratt's Stats® Transaction Report			Prepared: 8/18/2011 10:58:41 AM (PST)		
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		8-K Date:	3/11/2005	
SIC:	8734 Testing Laboratories		8-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	Number Employees:	CIK Code:	0001068874	
Income Data		Asset Data		Transaction Data	
Data is "Latest Full Year" Reported	Yes	Data is Latest Reported	Yes	Date Sale Initiated:	N/A
Data is Restated (see Notes for any explanation)	No	Data is "Purchase Price Allocation agreed upon by Buyer and Seller"	No	Date of Sale:	3/9/2005
Income Statement Date	12/31/2004	Balance Sheet Date	12/31/2004	Days to Sell:	N/A
Net Sales	\$8,151,567	Cash Equivalents	\$373,697	Asking Price:	N/A
COGS	<u>\$5,870,011</u>	Trade Receivables	\$856,637	Market Value of Invested Capital*:	\$14,021,000
Gross Profit	\$2,281,556	Inventory	\$0	Debt Assumed:	\$2,694,000
Yearly Rent	N/A	Other Current Assets	\$88,639	Employment Agreement Value:	N/A
Owner's Compensation	N/A	Total Current Assets	\$1,318,973	Noncompete Value:	N/A
Other Operating Expenses	N/A	Fixed Assets	\$4,163,861	Amount of Down Payment:	\$9,650,000
Noncash Charges	\$1,427,287	Real Estate	\$0	Stock or Asset Sale:	Stock
Total Operating Expenses	<u>\$1,677,851</u>	Intangibles	\$190,898	Company Type:	S Corporation
Operating Profit	\$603,605	Other Noncurrent Assets	\$87,678	Was there an Employment/Consulting Agreement?	No
Interest Expenses	<u>\$253,015</u>	Total Assets	<u>\$5,761,410</u>	Was there an Assumed Lease in the sale?	Yes
EBT	\$502,634	Long-term Liabilities	\$2,062,908	Was there a Renewal Option in the Lease?	No
Taxes	<u>\$11,218</u>	Total Liabilities	<u>\$3,402,658</u>	*Includes noncompete value and interest-bearing debt, excludes real estate, employment/consulting agreement values, and all contingent payments.	
Net Income	<u>\$491,416</u>	Stockholder's Equity	<u>\$2,358,752</u>		
Additional Transaction Information					
Was there a Note in the consideration paid? Yes			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 are not included in 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.					
Accurel is a commercial laboratory specializing in Failure Analysis Microscopy, Transmission Electron Microscopy and Focused Ion Beam Circuit Repair Services.					

5.0 Applying the Adjustments to Actual Data

To test the accuracy of the above-suggested adjustments, the Appraiser downloaded all the transactions from SIC classifications 7501 through 7599 from all three databases. There were a total of 489 transactions from the Pratt's Stats database, 668 from Bizcomps, and 881 from IBA. The data from each source was then adjusted using the suggested methods above. From the total 2,020 transactions there were 148 duplications between IBA and Bizcomps, 43 between IBA and Pratt's Stats, and 71 between Bizcomps and Pratt's Stats. It is from these duplications that we can see readily see if the suggested adjustments accounted for all differences between their respective presentations of data.

As the Appraiser noted in the Market Approach discussion, business brokers generally submit the same transactional data to all three databases and generally do not change any of the submitted data to conform to any database's procedural differences. Thus even though the manuals or on-line help screens of the respective databases indicate that there are a number of differences in the manner in which they calculate revenues, selling price, and SDE, in actual practice those differences are minimal.

5.1 IBA vs. Bizcomps

Selling Price

Of the 148 duplications, both IBA and Bizcomps reported the same selling price in all but 16 transactions. Of those 16, four IBA transactions had real estate included in the selling price. It was not obvious from the IBA data that it was. If it were not for the duplication in Bizcomps, we never would have known that real estate was included in those four IBA selling prices.

Four IBA transactions listed the selling price significantly less than SDE which was probably the result of data processing errors. Those four duplicates found in Bizcomps had selling prices considerably higher than SDE. The IBA selling prices, however, were so unrealistically low that we would have rejected those comparables even if we did not have Bizcomps for comparison.

After rejecting eight of the 16 transactions due to obvious errors, the remaining eight differences in reported selling prices were from either minor processing errors or perhaps procedural differences in the way each database calculated revenue. There was no way one could determine from the data which of the two types of discrepancies occurred. Thus after rejecting obvious data collection errors, at least 95% of the time IBA and Bizcomps calculated the selling price exactly the same way.

As was noted above, the IBA database claims that it deducts real estate value from the selling price. The Appraiser found 42 transactions out of the 148 where real estate was involved. In 27 of those transactions the real estate price was included in the total transaction price. Only 15 transactions deducted the real estate value as suggested in IBA's procedural manual. In almost every situation (except the four described above) the selling prices of those

comparables including real estate were so high with respect to their revenues that one could reasonably conclude that the real estate value should be deducted from the selling price. Again appraisers should use their judgment in reviewing the data and reject any comparable that is subject to doubt.

Revenue

All 148 revenue calculations were the same between the two databases; therefore, no adjustment is required for revenue.

SDE

Of 148 duplications there were only eight discrepancies in reported SDE. In three of those transactions IBA had the same value in the revenue and SDE data fields. Two transactions had real estate included which often leads to data processing errors. Thus after rejecting the obvious errors, the remaining three differences in reported selling prices were from either minor data processing errors or possibly procedural differences in the way each database calculated SDE. Regardless, 98% of the time IBA and Bizcomps reported the same value for SDE.

Even though IBA does not mention adding back depreciation to SDE¹⁸ whereas Bizcomps does, in practice IBA clearly appears to calculate SDE in the same way Bizcomps does.

5.2 IBA vs. Pratt's Stats

Selling Price

After making the suggested adjustments, all 43 duplications calculated selling prices the same way. Thus there were no other procedural differences in the way each calculated selling price.

Revenue

There were just three discrepancies in the listed revenue amounts out of 43 duplications between the two databases. All three discrepancies arose because IBA used the most current P&L data available, whereas Pratt's Stats used the P&Ls that were available when the sale began. Thus there were no other procedural differences in the way each calculated revenue.

SDE

After making the suggested adjustments for SDE noted in Paragraph 3.0, 21 discrepancies were found in the calculations for SDE out of the 43 duplications. Four differences were due to Pratt's Stats adding owner's compensation to operating profits of a sole proprietorship,

¹⁸ Market Analysis Tutorial #3 on IBA website, "IBA Transactional Database Fundamentals," <http://go-iba.org/market-data/tutorials/index.html>, 2009, p.1

which consequently double counted SDE (in a sole proprietorship operating profits are the owner's compensation; there is no separate owner's salary). Three errors arose because IBA used the most current P&L data available, whereas Pratt's Stats used the P&Ls that were available when the sale began. Seven other discrepancies were very obvious data processing errors. Only three of the discrepancies occurred because of procedural differences. Those were the result of IBA's stated policy of not adding back depreciation to SDE. Even though IBA states that it calculates SDE without adding back depreciation, only three instances in a combined 191 duplications between Pratt's Stats and Bizcomps proved that to be true. Thus IBA appears to calculate SDE the same way as the other two databases in over 98% of the time.

5.3 Bizcomps vs. Pratt's Stats

Selling Price

There were a total of 71 duplications between the Bizcomps and Pratt's Stats samples. Of that total only seven discrepancies appeared between their respective selling prices. Three of those transactions indicated that real estate was also sold. The selling prices reported by Bizcomps were so high with respect to revenues that one could conclude that real estate value was inadvertently added to the selling price. The cause for the remaining four discrepancies could not be determined by the data. However, those four discrepancies represent only 5% of the total duplicate transactions with Pratt's Stats' selling prices averaging just 7% higher than Bizcomps'. Thus the selling prices reported in these two databases appear to be reasonably similar after making the adjustments suggested in Paragraph 1.0.

Revenue

There were only a total of four discrepancies in the reported revenue of the 71 duplications between Bizcomps and Pratt's Stats. There was insufficient data to determine the cause of the discrepancies, but Pratt's Stats reported revenue averaged only 1% higher than Bizcomps' revenue. Thus revenues reported in these two databases appear to be reasonably similar after making the suggested adjustments.

SDE

As was the case in the duplications between IBA and Pratt's Stats above, the greatest number of discrepancies appeared in the SDE calculations. It is believed that most of the discrepancies occur as a result of the different reporting forms used by the databases. Since the wording for the various data points on each form is different, it is easy for brokers to be confused and enter incorrect information. Of the 71 duplications between Bizcomps and Pratt's Stats, there were 33 discrepancies. Of that total 16 were obvious data entry errors, not procedural differences. Typical errors were: 1) double counting owner's income when determining SDE of a sole proprietorship; 2) operating losses were not included in SDE calculations; 3) owner's salary was not added back to SDE; 4) depreciation was not added

back to SDE; 5) different P&L years were used by the different databases; and 6) real estate was also involved.

Of the remaining 17 discrepancies, one was found to be a procedural difference where Pratt's Stats deducted other income from SDE and Bizcomps did not. Sixteen discrepancies had insufficient data to determine whether the difference was due to simple data processing errors or procedural differences. Regardless, where discrepancies were not explainable Pratt's Stats SDE averaged only 1.4% less than the SDE reported by Bizcomps.

Summary

As we have seen above, transactions with real estate have a high percentage of selling price calculation errors. SDE calculations are also frequently done incorrectly. Many brokers do not understand how to properly calculate SDE when an owner of the business also owns the real estate. Brokers often add back the interest expense from the real estate mortgage to arrive at SDE for the business. Thus the calculated SDE will not have any occupancy costs making the company appear far more profitable than a company that pays rent. As a result, appraisers should use their judgment in selecting a transaction from any database that involves real estate. When there is any doubt, the comparable should be rejected.

Appraisers should also consider rejecting any comparable where the selling price or SDE appears to be extraordinarily high or low with respect to its revenue, or where data points are missing. Transactions with missing SDE or inventory (for companies that obviously should have inventory) give appraisers fewer critical data points to evaluate overall credibility of the transactional data. Liquor store sales, for example, are frequently reported with no inventory. Buyers and sellers typically enter into side agreements to pay for the inventory outside of escrow. As a result, even though a moderate level of inventory passed to the buyer, the transaction does not reflect it. The actual selling price of that business will appear very low compared to a similar store that sold with inventory included in the sale price.

Stock transactions are also highly prone to calculation errors by the submitting brokers. For example, corporations are frequently sold with receivables or other assets or liabilities included. The broker may report the selling price with receivables, but neglect to indicate that they were included in the selling price. The selling price may also have been reduced by the amount of liabilities assumed by the buyer. The broker may report the reduced price but neglect to mention that there were assumed liabilities in the transaction. As a result, the selling price of transactions sold as Stock Sales are often misinterpreted by brokers. Thus as mentioned in Paragraph 4.0, unless a specific selling price allocation is provided with the transactional data, appraisers probably should not attempt to reconcile the value to an equivalent Asset Sale price.

**Resume of
C. Frederick Hall, III, MBA, CBA, CVA
10300 Argonaut Drive
Jackson, CA 95642
209-256-1371**

Education: B.S. in Business Administration from U.C. Berkeley
MBA degree in Business Finance and Computers from San Diego State University

Completed the following course work with the IBA and received the designation of CBA (Certified Business Appraisers)

8001 A & B	Appraisal Skills Workshop	64 Hours
1060	Appraisal Writing	16 Hours
	Annual CPE Appraisal Workshops	<u>65 Hours</u>
		145 Hours

Completed Requirements for CVA certification (Certified Valuation Analyst) with the National Association of Certified Valuation Analysts (NACVA)

Experience:

1971 to 1975 - Business Analyst and Commercial Loan Officer at Union Bank in th San Francisco and Los Angeles headquarters offices. The first year involved a management training program that included nine months (at 40 hours per week) of financial analysis and legal environment of business lending, followed by three months of in-the-field appraisal training.

1975 to 1978 - Purchased and operated a retail hardware company in Portola Valley, California.

1977 to 1981 - Served on the Board of Directors and functioned as the CFO for Bay Cities Wholesale Hardware Company, a dealer-owned co-operative comprised of 350 stores in Northern California. Dealt with many union problems, a warehouse relocation from San Francisco to Manteca, and a complete computerization of operations.

1978 to 2002 - Built a ground up retail hardware and lumber company in Pine Grove, California. The company went through four major expansions during this period. By 2002 the store grew to \$5,000,000 in annual revenues and 30 employees. From 1987 to 2002 I completely automated the company at all levels and networked together a dozen workstations. I personally wrote scores of computer programs that involved every aspect of the operations, including inventory control, general ledger bookkeeping, accounts receivable, accounts payable control, and a complex payroll program.

2002 to 2005 - Business Broker and Business Analyst for Sunbelt Business Advisors of Sacramento and Reno. During this period successfully completed the course work for business appraisals offered by the IBA (Institute of Business Appraisers) and received the designation of CBA.

2005 to 2009 - Managing partner of Compass Point Capital, specializing in mergers and acquisitions of smaller mid-sized companies ranging in revenues from \$5 to \$25 million.

2003 to Present - Wrote business valuations for over 400 companies. During this time I regularly presented lectures on business valuation techniques to a number of professional organizations in Northern California. I presented classes on valuations, accounting, and taxes at the Annual Murphy Business and Financial Convention in Florida. Attendees included brokers, bankers, and accountants.

I have written approximately 50 appraisals involving marriage dissolutions and partnership breakups which often required presenting and defending the findings to both parties and their attorneys. Approximately 50 appraisals were done at the request of several SBA Banks for the loan applicants. Those banks include Bank of the West, Plumas Bank, Northern Nevada Bank, Temecula Bank, Comerica, Bridge Bank, River City Bank, Five Star Bank, First

C. Fred Hall, III, MBA, CBA, CVA
10300 Argonaut Drive
Jackson, CA 95642

Recent Clients:

Bank of the West Scott VanderLohe Sacramento, CA	Northern Nevada Bank Bryan Wallace Reno, NV	ProSource Sales and Mkt Gail Sievers Sparks, NV	Wright Outdoor Center Jim Wright Sparks, NV
ScareCrow Lath & Plaster Steve Crow Reno, NV	Lake Bar & Grill Robert Treanur Sparks, NV	Nelson Logistics Jeffery Ting So.San Francisco, CA	Chase Western Cabinets Brett Zunino Reno, NV
North Valley Athletic Club Scott Schofield Chico, CA	Mueller Fitness Center Vance Mueller El Dorado, CA	MAACO Art Alvi North Highlands, CA	Consign-It Bonnie Grisel Rancho Cordova, CA
Liquor Cabinet Manjeet Sandhu Corning, CA	Lighting Unlimited Dean Osborn El Dorado, CA	LA Pines Building Supply Pat Lawrence Portland, OR	Kidz Love Soccer Chris Trevisan Cupertino, CA
Holiday Grocery Jim Lumley Marysville, CA	Golden Years Retirement Jace Schmitz, Coldwell Banker Port Angeles, WA	GHH, Inc. Environ.Eng. Gary Hall Auburn, CA	Doyle's Steel Terry Henry Modesto, CA
DEA- Bathroom Machinery Tom Scheller Murphys, CA	Cal Inc. Environmental Training Mike McCalmont Vacaville, CA	B & J Unical Gas John Rockwood Grass Valley, CA	Putnam HVAC John Putnam Rancho Cordova, CA
Tom's Ace Chris Doyle San Leandro, CA	Teresa's Place Restaurant Phil Giurlani Jackson, CA	Pine Cone Pharmacy Paul Wesseler Pine Grove, CA	Sierra X-Ray Services Pete Kohler Reno, NV
Oak's Hardware Dave Hill Fair Oaks, CA	Dixon Lumber Bryan Bock Dixon, CA	Davenport Lumber Doug Allen Davenport, WA	Tender Touches Spa Barbara Brown Sequim, WA
Meineke Auto Care Dave Sparks Gladstone, OR	Foothill Ace John Norris Oregon House, CA	Columbia Nursery & Florist Janet Ofstad Columbia, CA	Twin Cities Bike and Repair Rick Elia Yuba City, CA
A & J Paving Allen & Joan Ashby Reno, NV	Tony Don Michael MD Bakersfield, CA	Applied Control Electronics Terrence Burke Placerville, CA	Mark Bailey Plumbing Lisa Bailey Susanville, CA
Garden Valley Feed Manuel Vieira Garden Valley, CA	Great Shape of America Steve Lubarsky Los Angeles, CA	Imperial Steel & Tube Rick Stamper Perris, CA	Wood Rat Productions Dennis McKee Murrietta, CA
Hayward Ace Hardware Andrew Lee Hayward, CA	Rossi Building Materials Richard Nelepovitz Fort Bragg, CA	Thrillworks Extreme Eng. Jeff Wilson Newcastle, CA	Outhouse Collection Jeanette Skaff Arnold, CA
Cameron Ace Hardware Barry Pino Cameron Park, CA	Divide Supply Jerry Hoyt Greenwood, CA	Ameritech Propeller Kerry Dawes Redding, CA	Auction City Flea Market Emil Magovac Sacramento, CA.
Mark Bailey Plumbing Lisa Bailey Susanville, CA	Big O Tires Scott Davis Sparks, NV	Bill-Rite Mgmt Services Lorrie Bosick Newcastle, CA	California Movers Express Michael Szura Hayward, CA
Capital Towing Carson City, NV	Carpets of America Ray Crandell Sparks, NV	Chamois Car Wash Mark Gambardella Danville, CA	Claypool's Market Fred Claypool Pine Grove, CA
Cypress Systems Robert Crocitto Reno, NV	Dangermond & Assoc. Engineering Peter Dangermond Sacramento, CA	Empire Stores Kim Deol San Leandro, CA	Great Shape of America Steve Lubarsky Los Angeles, CA

Appraiser's Certification

I certify that, to the best of my knowledge and belief:

1. The statements of fact contained in this report are true and correct to the best of my knowledge and belief, subject to the assumptions and conditions stated.
2. The reported analyses, opinions and conclusions are limited only by the reported assumptions and limiting conditions and are my personal, unbiased, and professional analyses, opinions, and conclusions.
3. I have no present or prospective interest in the property that is the subject of this report, nor is my compensation dependent upon the value of this report or contingent upon producing a value that is favorable to the client.
4. I have no personal bias with respect to the parties involved or have made a full disclosure of any such bias.
5. This appraisal has been conducted and the report was written in conformity with the Business Appraisal Standards of the Institute of Business Appraisers.
6. No person except the undersigned participated materially in the preparation of this report.



C. Frederick Hall III, MBA, CBA, CVA

April 1, 2015

Date

By accepting this report, the client agrees to the following terms and conditions:

1. The appraisal report will not be given to any other party without the Appraiser's approval.
2. You agree to indemnify and hold the Appraiser, Amador Appraisals and Acquisitions, and their officers and employees harmless against and from any and all losses, claims, actions, damages, expenses, or liabilities, including reasonable attorney's fees, to which we may become subject in connection with this engagement. You will not be liable for our negligence.
3. You agree that, in the event we are judicially determined to have acted negligently in the execution of this engagement, damages shall be limited to an amount not to exceed the fee received by us for this engagement.
4. Our liability for injury or loss, if any, arising from the services we provide to you shall not exceed \$5,000 or our fee, whichever is greater. There shall be no punitive damages. Increased liability limits may be negotiated upon your written request, prior to commencement of our services, and your agreement to pay an additional fee.
5. Your obligation for indemnification and reimbursement shall extend to any controlling person of Amador Appraisal and Acquisitions, Inc., including any director, officer, employee, subcontractor, affiliate or agent.
6. If in the future the Appraiser is called upon to testify in court or at deposition regarding the written report, the Appraiser will be paid \$150.00 per hour to cover professional time, the gathering of materials, reviewing the case, and preparing for testimony along with other expenses incurred.
7. If called upon to defend this report to any other party, the Appraiser's expenses and hourly rate will be billed on a monthly basis or as incurred.
8. The client will shoulder the responsibility of legal costs incurred by the Appraiser when defending this appraisal.
9. Client agrees that the Limiting Conditions as stated in the report will be acceptable with the level of work and detail of work to be performed.
10. In the unlikely event of a dispute, the parties under the terms of this agreement shall be subject to arbitration. Arbitration shall be conducted in Amador County, California.



Central Area Upstairs Main Office



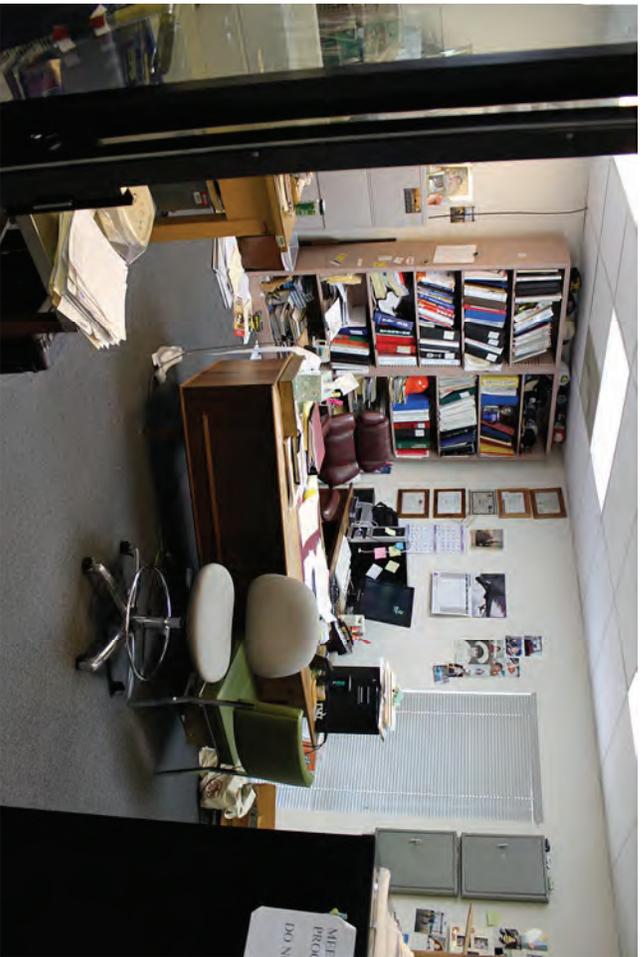
Conference Room #3



Employee Christmas Photo



President & CEO Office



Vice President Office



CAM Programming Office



1 of 4 Estimating Dept. Cubicles



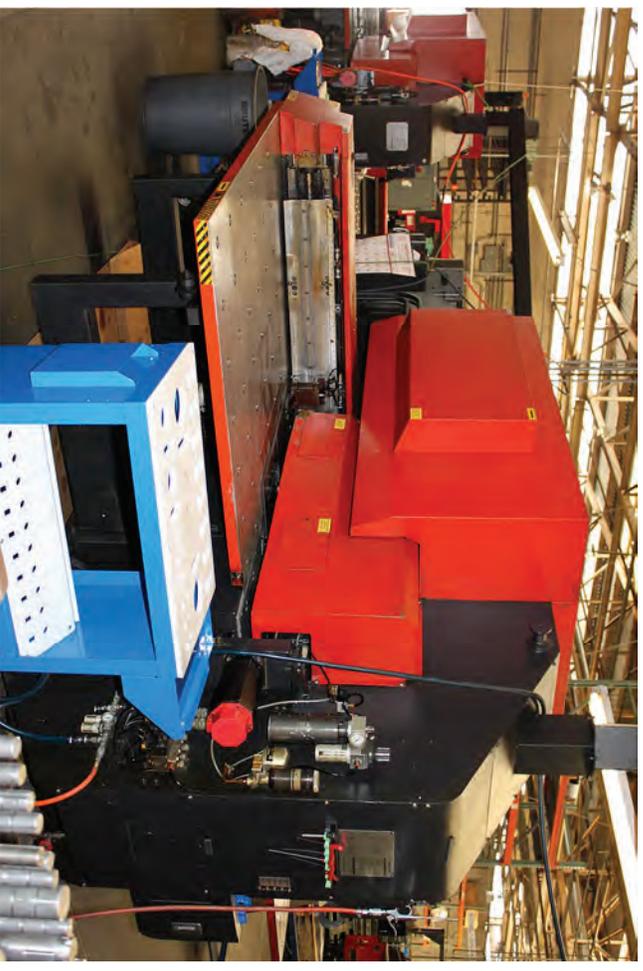
1 of 7 Engineering Dept. Cubicles



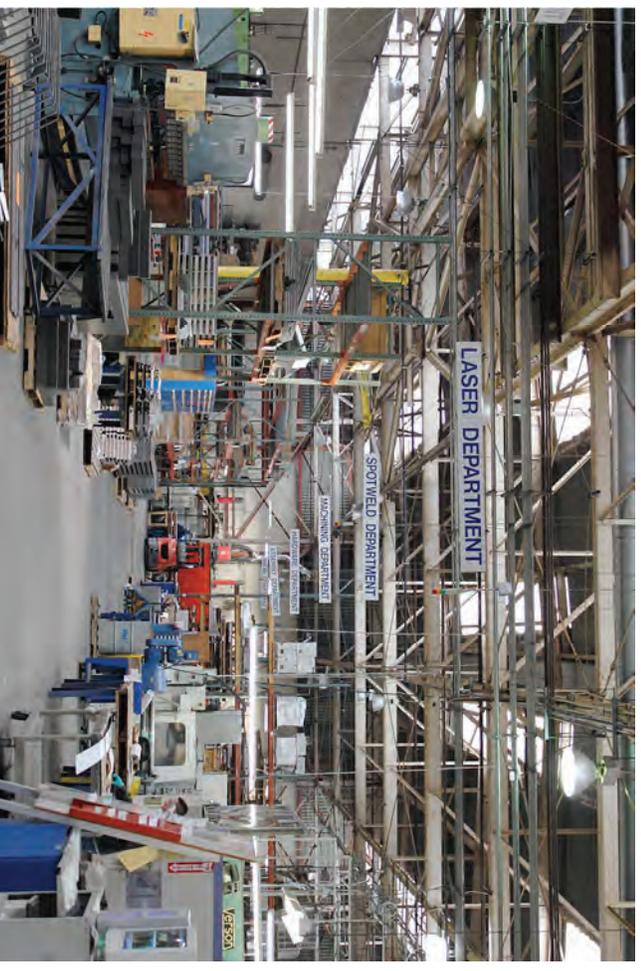
Engineering Documentation Clerk Cubicle



1 of 7 Engineering Dept. Cubicles



1 of 4 CNC Punch Presses



General View Fabrication Shop



Brake Department



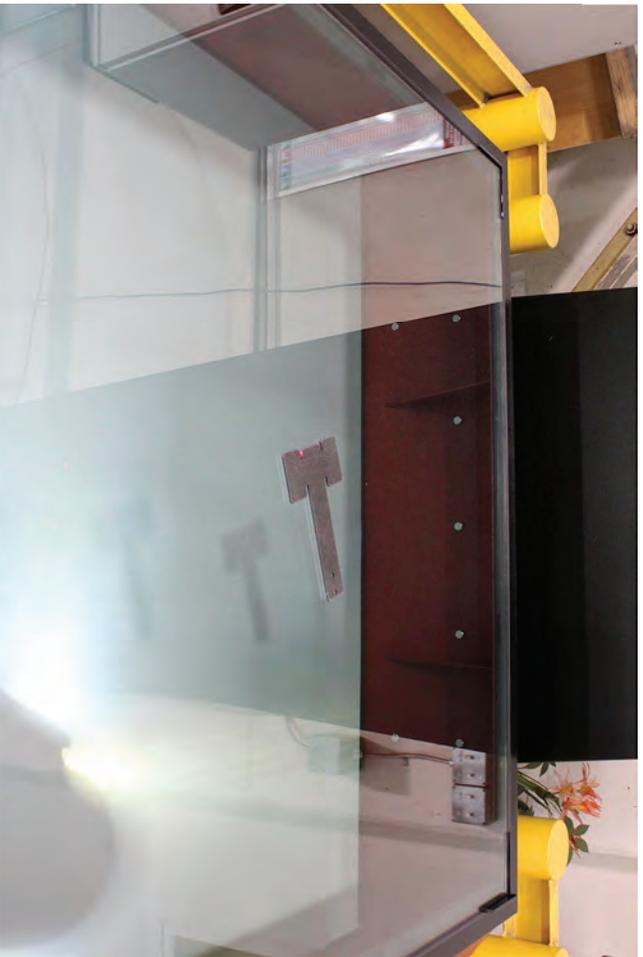
1 of 7 CNC Sheet Metal Brakes



1 of 4 CNC Punch Presses



2 of 4 CNC Punch Presses



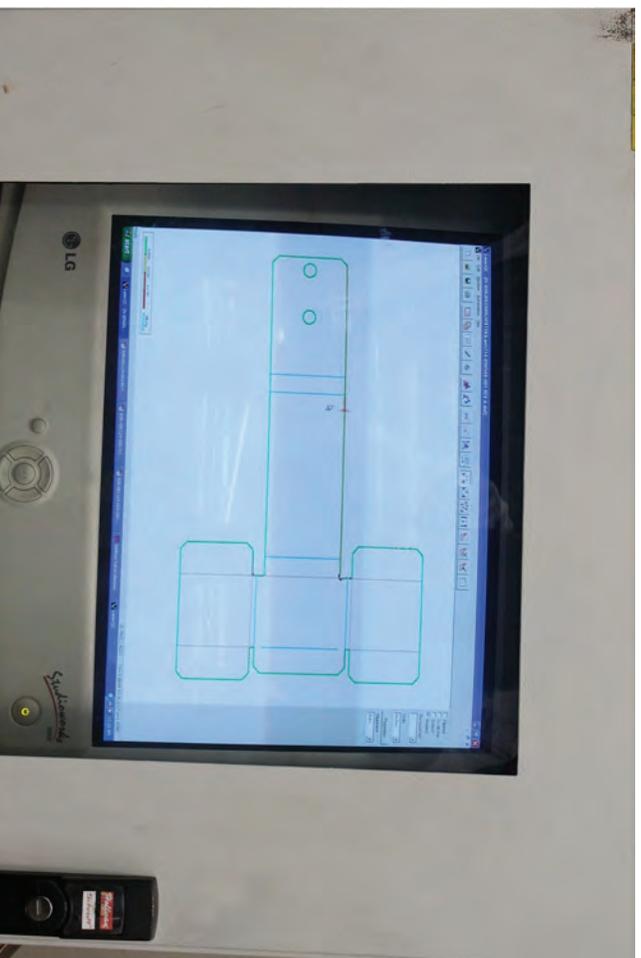
Vitek Sheet Metal QC Scanner In Use



Vitek Sheet Metal QC Scanner



Vitek Sheet Metal QC Scanner In Use



Vitek Sheet Metal QC Scanner In Use



5 Axis CNC Tube Laser



1 of 4 CNC Punch Presses



1 of 2 CNC Mitsubishi CO2



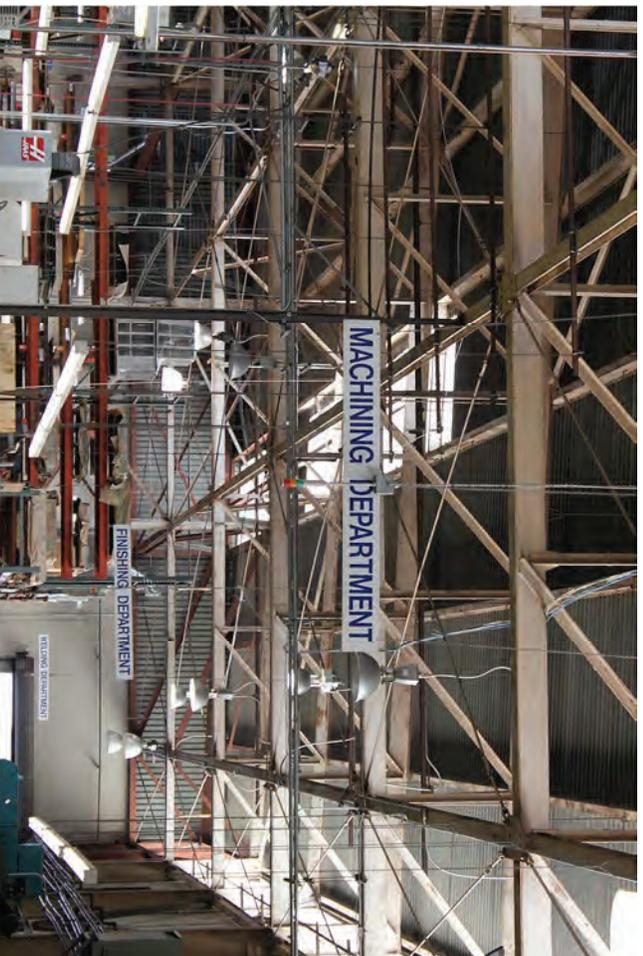
1 of 4 CNC Punch Presses



Brake Department



CNC Machining Department





Tool Crib & Hardware Inventory Department



Kitting Packs for Hardware Department use



QC Department



1 of 2 Optical Comparators



CNC Water Jet Cutting Machine



CNC Water Jet Cutting Machine



Job Boss MRP System Data Entry Station



Machining Department



Hardware Insertion Department (prior to 5S improvement completion)



Haeger 824 Hardware Insertion Press



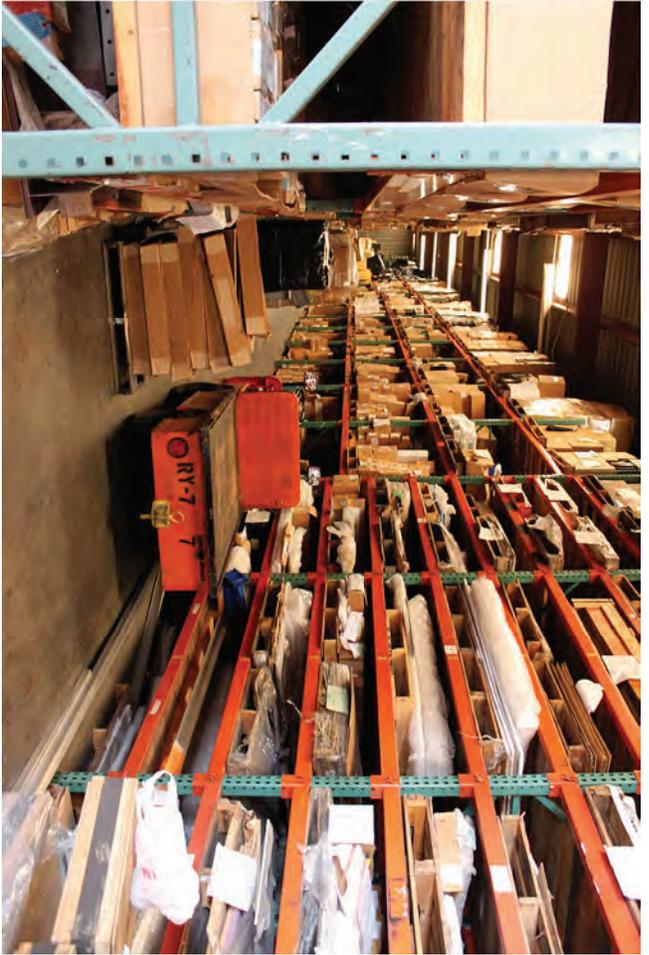
JIT & Overrun Inventory Warehouse



JIT & Overrun Inventory Warehouse



JIT & Overrun Inventory Warehouse



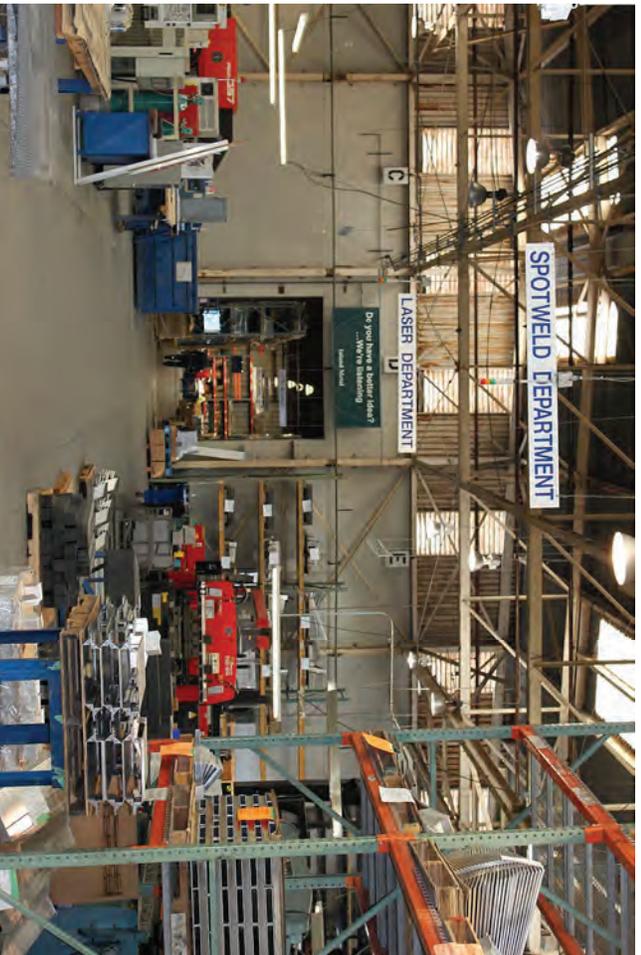
JIT & Overrun Inventory Warehouse



1 of 7 Welding Department Stations



1 of 7 Welding Department Stations



General Shop View Toward Assy Department



1 of 7 Welding Department Stations



1 of 7 Welding Departments Stations



Grinding and Polishing Department



1 of 7 Welding Departments Stations



Sheet Metal Storage Rack



Machining Department Work Station



Machining Department Work Station



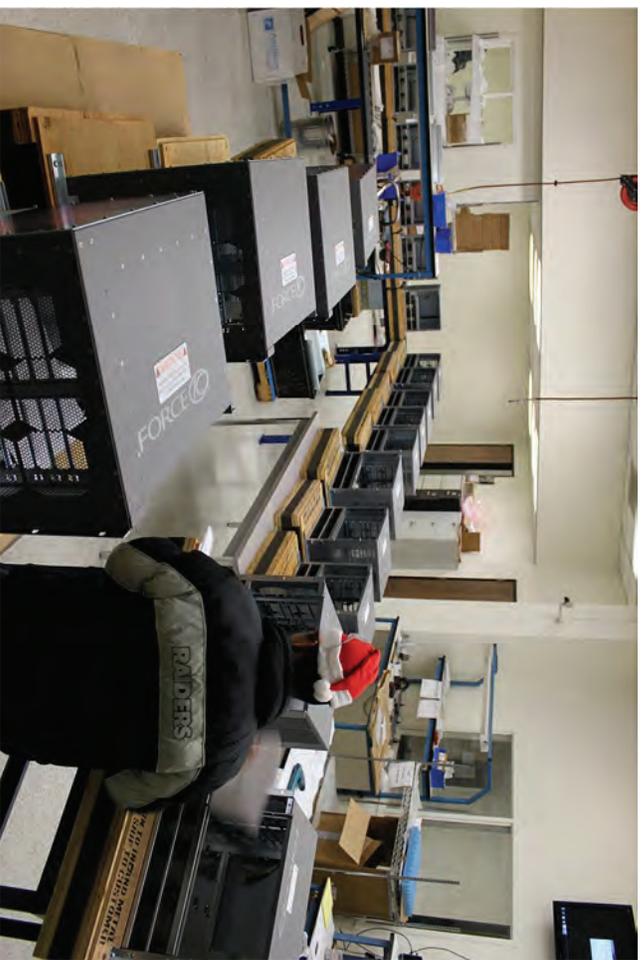
Assy Area



General View Assembly Department



Assy Department Tesla Box Assy Line



Assy Area



Assy Department View



Assy Department Aisle



Induction Soldering R&D in Process in ESD Assy Area



Antenna Soldering Station in Assy Area



ESD Room in Assy Area with 2 Large Environmental Chambers



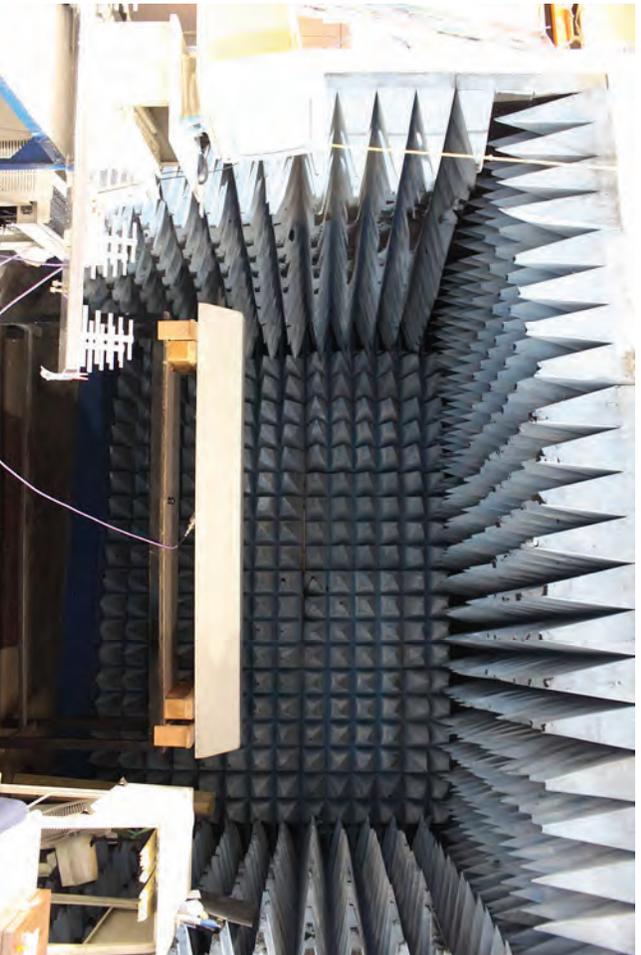
Antenna Assy Station



Antenna Assembly Area



Packaged Parts Returning from Outside Process (Note yellow cone)



1 of 2 Anechoic Test Station for Cell Antennas



Shipping & Receiving Area