

# COMMERCIAL LOANS UPDATE #53 From George Heaslip

## How Much Is A Business Worth?

Buyers of a commercial business must look at several factors in several categories.

### Current Market Value

- > Land (if any)
- > Building(s) (If any)
- > Equipment, which may include vehicles.
- > Furniture, Fixtures and Inventory
- > Lease agreements
- > Adjusted net profit (not the net profit reported on page one of the tax return!)

Remember, if land and building is involved, a commercial lender will order an appraisal, which the loan applicant must pay for. Depending on where the building is located, and what is near it, the lender will order a Phase I Environmental Study, the applicant has to pay for this; it actually protects the applicant from a potentially bad deal.

The value of a business is based on two things: what it owns and what it earns.

### What It Owns

A business has tangible and intangible assets. The tangible assets are the furniture, fixtures, equipment, inventory, and real estate. In the case of a trucking company, or limo service company, the “street value” of the vehicles can be used as part of the collateral, but the lender gets a first position lien on each unit. The intangible assets can include the trade name, contracts, leases, client lists, licenses, recipes, and patents.

### What It Earns

A business provides a certain financial benefit to the owner. The benefit generally comes in the form of business profits and a salary to the owner. It can also provide the owner with fringe benefits such as health insurance, a company car, or a retirement plan.

### How Value Is Calculated

Owner operated businesses with sales of \$1 million or less generally sell for the value of the assets, plus one to three times the earnings. If the earnings are stable and growing, the value is on the higher end. If the earnings are variable or declining, the value is on the lower end.

Businesses with sales or service provisions of \$1 million to \$10 million may sell for straight earnings multiples of three to six. A thorough investigation of the financial information is required to uncover the true earnings capability of the business. Again, if the earnings are stable and growing, a higher multiple is used. If the earnings are variable or declining, a lower multiple is used.

Businesses with sales of more than \$10 million often have specific industry criteria, which may be applied to determine the value. At this level, buyers may be paying for market share, rights to patents and processes, additions to product lines, or the benefits of strategic or administrative consolidation.

## Rules Of Thumb

Most industries have one of more rules or thumb. However, they can vary widely and in most cases do not give an accurate value of a business. Since each business is unique, a particular rule of thumb can be off by as much as 100% or more. The business valuator will be able to decide what is the most relevant information about a business and then make an informed decision about its value.

The value of a business valuator.

Business valuation is as much an art as a science. While the business valuator does employ standardized formulas and methods to calculate value, he works from assumptions that are based on his experience in the market place and his familiarity with the similar businesses. This process includes the selection of the most appropriate risk and return variables. In this way, his applied expertise leads to the best calculations of value for a specific business.

## Simple Equation

For someone wanting to buy a business, whether real estate is involved or not, here is the magic from George:

> Examine the last three years of 1120 tax filings, and go to the "Other Deductions" section to see where money is hidden. 92% of all business tax forms are fraudulent and the IRS does not have time to spend time with the small businesses, like mom and pop restaurants, auto repair shops, limo service companies, or coffee shops... Find the hidden money and add it back to line 30 or 31 on the tax form (depending on year)...these are called "add-backs" meaning the expenses that the new owner will not incur. This gives you "Adjusted Net Profit."

> Tell me about the competition and the demographics (you will need a business plan if you need a loan). I say that if the business is stable, and has been... the number is 2.0

If, under your leadership, the business can grow by 10-20% after you receive a loan, the number is 2.5. If you convince me that you have ways of getting the competitive edge by the end of 12 months after you receive a loan, the number is 3.0.

## What Should You Pay For The Business?

Here we go....

Business Value:

- (1) Value of furniture, fixtures and equipment
- (2) Inventory
- (3) Value of vehicles to be purchased, if any
- (4) Value of the land and building to be purchased, if any
- (5) Good will, this is pure "bull" so forget about it, the value is ZERO!

Please add (1) through (4)

Note the total, this becomes

- (6) Total Hard Assets

Now take the adjusted net profit, per my instructions above and multiply it by a factor of between 2.0 and 3.0, be honest please since the bank will do its own investigation if you have a shaky business plan. Business evaluations can go as high as \$3,500 (example, Banco Popular).

Write down the number, this becomes

## (7) Business Worth

Now add (6) and (7)... this is the fair selling price. If the selling price is above this number, run, run, run.

## What The Lender Wants To See

Net Profit, per my guidance per month, divided by the loan payment per month must be 1.25 or higher, or the deal is dead.

Work out the numbers..... per each \$100,000 borrowed on a lease deal

7 years: \$1,686 per month

10 years: \$1349 per month

If real estate is involved,

20 years: \$998 per month

25 years: \$944 per month

The above is based on a typical interest rate, commercial of 10.5%. Interest rates are based on the Wall Street Journal Prime Rate, and are typically adjusted by the lender on a quarterly basis. My projection is that the rate will fall 1/4% within the next three months

Remember, the applicant needs experience, a credit score of over 650, no records of arrests, and will have to show collateral backup for the loan, usually a home or property owned by he or she, or a co-applicant.

For further information contact:

George B. Heaslip  
East Coast Loan Services  
110 Bent Tree Drive  
Palm Gardens, FL 33418  
Tel: 561-626-9599  
Cell: 561-329-1315  
Fax: 561-799-5801  
Email: [gbh11704@aol.com](mailto:gbh11704@aol.com)