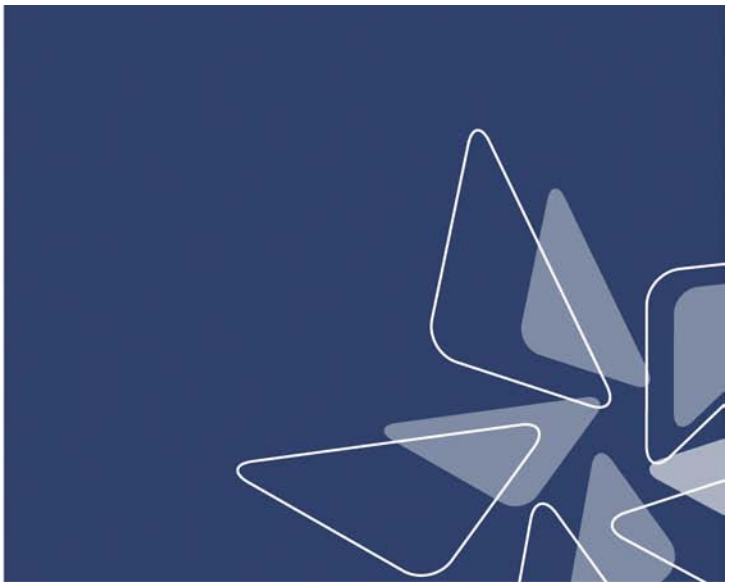


Valuation Of:	**XYZ Animal Hospital**
Valuation Date:	**September 30, 2009**
Report Date:	**January 22, 2010**
Prepared By:	**Steve Mize, ASA**
Prepared For:	**Live Oak Bank**

Prepared by:

GCF Valuation

701 S. Howard Avenue, Suite 203
Tampa, FL 33606

813.258.1668 *office*
888.893.1803 *toll free*

gvalue.com

Reference # 2230

Opinion of Value

The undersigned appraiser, using accepted methods of valuation and subject to the assumptions and limiting conditions incorporated herein, has estimated the Fair Market Value of the 100% Asset Interest of XYZ Animal Hospital, as of September 30, 2009 to be best expressed as:

$540,000 (rounded)

Appraiser's Certification

1. The statements of fact expressed herein are true and correct to the best of the appraiser's knowledge and belief. The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions and are the appraiser's personal, impartial, unbiased opinions, professional analyses, opinions and conclusions.

2. Neither Steve Mize nor any employee of GCF Valuation, nor any of the appraisers who contributed to this report has any present or prospective interest in the subject property; nor any personal interest with respect to the parties, nor any other interest or bias which would impair a fair and unbiased appraisal.

3. Compensation paid to the appraiser for this appraisal is independent of the value reported. It is not contingent on the development or reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of the appraisal.

4. The appraiser HAS NOT made a personal inspection of the subject property.

5. This appraisal has been conducted and this report issued pursuant to the Business Appraisal Standards and Code of Ethics of the Institute of Business Appraisers; the Principles of Appraisal Practice Code of Ethics of the American Society of Appraisers, and the Uniform Standards of Professional Appraisal Practice in effect at the date this report is issued.

6. Doug Teten has helped with the research and analysis, but has not acted as an "appraiser". No person except the undersigned participated materially in the conclusion of this appraisal.

The value considerations herein are contingent upon the analysis, and limiting conditions as set forth in the body of the report.

_____

Steve A. Mize, ASA

Executive Summary

Business Name: XYZ Animal Hospital

NAICS / Industry: 541940 – Veterinary Practice

Estimate of Value: $540,000 for the 100% Asset Interest (see below for assets & liabilities included). A summary of the economic value basis and ending "multipliers" are shown below:

Table 1
Valuation and Multiples

Economic Basis	
Projected Revenue	$620,288
Projected EBITDA	$148,626
Projected Seller's Discretionary Earnings (SDE)	$244,004
Values	
Final Value (all assets and liabilities included)	$540,000
Enterprise Value (fixed assets, inventory & goodwill)	$540,476

Value Multiples	3-Year Average	Last Full Year	Appraiser Projections
EV / Revenue	0.79	0.86	0.87
EV / EBITDA	2.65	3.02	3.64
EV / SDE	1.75	1.96	2.22

Adjusted Balance Sheet: The calculation of value assumes the following assets and liabilities are included in the sale (see table 3.4.1a for balance sheet adjustments made):

Cash Assumed	$0
Accounts Receivable Assumed	$0
Inventory Assumed	$0
Other Current Assets Assumed	$0
Fixed Assets Assumed	$96,282
Other Assets Assumed	$0
Excess Working Capital Assumed	$0
Other Non-Operating Assets Assumed	$0
Total Liabilities Assumed	($0)
Assets Less Liabilities Assumed	$96,282
Estimated Goodwill [1]	$443,719

[1] "Final Value" minus ("Assets Less Liabilities Assumed")

Table 2
Adjusted Cash Flow Analysis

December:	Tax Return 2006	Tax Return 2007	Tax Return 2008	Projected 2009
Revenue				
Gross Sales	$710,955	$721,160	$629,603	$487,759
Sales Adjustment	$0	$0	$0	$0
Adjusted Sales	$710,955	$721,160	$629,603	$487,759
Cost of Goods Sold				
Historical Cost of Goods Sold	$161,325	$142,624	$174,672	$114,248
COGS Adjustment	$0	$0	$0	$0
Adjusted COGS	$161,325	$142,624	$174,672	$114,248
Cash Flow Adjustments				
Interest expense	$0	$0	$0	$0
Depreciation/Amort.	$2,433	$2,144	$49,498	$1,683
Officer compensation	$360,000	$360,000	$120,000	$120,000
Other add-backs	$0	$0	$0	$0
Other add-backs	$0	$0	$0	$0
Other add-backs	$0	$0	$0	$0
Other add-backs	$0	$0	$0	$0
Other add-backs	$0	$0	$0	$0
Other add-backs	$0	$0	$0	$0
Historical rent	$0	$0	$0	$0
Fair market rent	$0	$0	$0	$0
Total Add Backs	$362,433	$362,144	$169,498	$121,683
Cash Flow Calc.				
Pre-Tax Profit +	($56,575)	($15,339)	$106,248	$11,023
Total Adjustments =	$362,433	$362,144	$169,498	$121,683
Seller's Discretionary Earnings	$305,858	$346,805	$275,746	$132,706
Less Replacement Salary	($109,320)	($110,889)	($96,811)	($75,000)
EBITDA	$196,538	$235,916	$178,935	$57,706
as % of Sales	27.64%	32.71%	28.42%	11.83%
Cash Flow Weight	10%	20%	30%	40%
Weighted Revenue	$599,312	*100.00%*		100%
Weighted SDE	$235,753	*39.34%*		
Weighted EBITDA	$143,600	*23.96%*		

Extraordinary Assumptions & Financial Summary: None.

Table 3
Summary of Valuation Methods

Valuation Method	Value and Basis Indicated By Method	Adjustments for Differences in Degree of: Marketability	Adjustments for Differences in Degree of: Control	Adjusted Value and Basis	Confidence Level	Incremental Value
Cost Approach						
Adjusted Book Value	$96,282 Illiquid, Control	0%	0%	$96,282 Illiquid, Control	0%	$0
Market Approach						
Direct Market Data Method (DMDM)	$546,432 Illiquid, Control	0%	0%	$546,432 Illiquid, Control	50%	$273,216
Income Approach						
Capitalization of Net Cash Flow	$519,953 Liquid, Control	10%	0%	$467,958 Illiquid, Control	25%	$116,989
Capitalization of Discretionary Earnings	$601,085 Illiquid, Control	0%	0%	$601,085 Illiquid, Control	25%	$150,271
Value Conclusion						
Fair Market Value: 100% Interest - Private / Illiquid, Control Basis - Excluding Nonoperating As					100%	$540,476
Fair Market Value: Excess Working Capital						$0
Fair Market Value: Other Nonoperating Assets						$0
Fair Market Value: 100% Interest - Private / Illiquid, Control Basis - Including Nonoperating Assets						$540,476
Interest Appraised						100%
Value Conclusion						$540,476
Value Conclusion (rounded)						$540,000

Valuation Summary: None.

Table of Contents

1.0 Introduction

1.1 Subject of the Appraisal

GCF Valuation was retained by Jason Canup of Live Oak Bank to estimate the Fair Market Value of the 100% Asset Interest of XYZ Animal Hospital, herein described as "XYZ Animal Hospital" or "the Company".

1.2 Purpose and Use of the Appraisal

This appraisal is expected to be used by the client, Live Oak Bank , in its determination whether or not to make a loan to the borrower(s). This report is not intended for any other purpose, and the conclusions found herein may not be applied to other purposes without additional consideration of all the relevant facts.

1.3 Intended Users

The use of this report and the information contained in it is restricted to use by Live Oak Bank and the SBA for the purpose set forth above in Section 1.2. All others possessing this report are not intended users. The appraiser does not authorize and is not responsible for use of this report by any party other than the client or an intended user. Intended users may not provide this report to any third party without the prior written consent of GCF Valuation.

1.4 Date of the Valuation

The effective date: September 30, 2009[2]
The report was issued: January 22, 2010
The inspection date: None[3]

1.5 Form of Report – Summary Restricted Use Appraisal Report

The following is considered a summary report. It is not within the scope of this assignment for the reader to replicate the value conclusion; however, the full scope of the value conclusions and evidence for support of the financial calculations are included in my work files according to USPAP, IBA, ASA and AICPA / SSVS standards.

Although the Uniform Standards of Professional Appraisal Practice (hereafter known as USPAP) recognize only two reports (Appraisal Report and Restricted Appraisal Report), many practitioners offer a summary appraisal report. I've outlined definitions of a "summary appraisal" from the 3 primary business valuation organizations:

American Society of Appraisers (ASA): The ASA Business Valuation Standards (BVS-VIII) state "A business valuation report may be less comprehensive in content provided that the report complies with the minimum content required by Standard 10.2 of the USPAP.

[2] The effective date is the date of the latest financial statement.
[3] To minimize fees and expedite a report, the client did not request a site visit. The appraiser was engaged subject to time and budget limitations.

Institute of Business Appraisers (IBA): The IBA acknowledges a "summarized report" in IBA BV Standard 4.1 and notes that "By its nature the letter form of report is an instrument of brevity. It should contain at least a summary of the material factors that led to its conclusions, but is usually intended by the parties [to the appraisal engagement contract] to reduce the normal appraisal burden of writing a comprehensive report, and thereby allow the client to realize some economic benefit. However, the appraiser is still required to perform materially the same investigation and analysis as would be required for a comprehensive report and maintain in his files the work-papers necessary to support the conclusions stated in the letter form report."

American Institute of Certified Public Accountants (AICPA): The AICPA defines a "Summary Report" as, "A summary report is structured to provide an abridged version of the information that would be provided in a detailed report, Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset and therefore, need not contain the same level of detail as a detailed report."

USPAP states the essential difference between an Appraisal Report and a Restricted Appraisal Report is in the content and level of information provided. The appropriate reporting option and the level of information necessary in the report are dependent upon the intended use and intended users. A Restricted Appraisal or Summary Report is appropriate where, as in this case, the intended readers of the report are already familiar with the pertinent features of the company, its markets, financial performance and the industry environment in which the Company operates.

1.6 Standard of Value

The standard of value applied for this appraisal is Fair Market Value. Revenue Ruling 59-60 is quoted on the following page and is the most broadly accepted definition:

> …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.[4]

As used here, this definition of Fair Market Value includes the following assumptions:

- The hypothetical prospective purchaser is prudent and profit seeking, and **without any synergistic benefit**. The buyer is also anonymous, represents an arms-length interest, and is presumed to be financially capable of closing.
- The hypothetical seller is also anonymous and thought to be acting prudently, with knowledge of the market with respect to risk and return from alternative investments, the effect of control characteristics on value, and the effect of lack of marketability.
- The business will continue as a going concern and not be liquidated.
- The business will be sold for cash or cash equivalent.
- The business would be held on the market for a reasonable period of time.

[4] Internal Revenue Service, *Revenue Ruling 59-60*, Section 2. Background & Definitions.

1.7 Control and Marketability of Interest Valued

The subject interest is assumed to be transferable, but such transfer is subject to the legal restrictions imposed by law on unregistered securities. I've been engaged by the client to estimate the value of a 100% controlling interest of selected assets and/or liabilities. Therefore, discounts for lack of control or marketability are not warranted.

1.8 Brief Description of the Subject Company

XYZ Animal Hospital is best described by North American Industrial Classification System Code (NAICS), 541940. The Company is located at _____. As indicated above, the subject interest represents a 100% controlling non-marketable (privately held) value of selected assets and liabilities.

1.9 Scope of the Assignment

It is assumed that the appraiser shall rely upon the facts and financial information provided by the buyer, seller and lender to prepare the appraisal. Therefore, neither the engagement nor the report can be relied on to disclose any misrepresentation, fraud, deviations from GAAP or other errors or irregularities. The appraiser was retained subject to time and budget limitations. While the appraiser's research, process and analysis were both adequate and reasonable for the scope of the project, they were not unlimited in scope.

The appraiser's research and analysis included, along with other issues, consideration of the eight valuation factors identified in IRS Revenue Ruling 59-60 namely:

1. The nature of the business and the history of the enterprise from its inception. (Sec 2)
2. The economic outlook in general and the condition and outlook of the specific industry in particular. (Sec 2)
3. The book value of the stock and the financial condition of the business. (Sec 3)
4. The earning capacity of the company. (Sec 3)
5. The dividend paying capacity. (Sec 3)
6. Whether or not the enterprise has goodwill or other intangible value. (Sec 3)
7. Sales of the stock and the size of the block of stock to be valued. (Sec 1 and 2)
8. 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. (Sec 4)

An appraisal of fixed assets was not performed by GCF Valuation. The appraiser has relied on management estimates and allocations. Due to time and budget restraints, the appraiser did not conduct a site visit. Due to normal confidentially reasons in an acquisition, I have not conducted interviews with the Company's employees.

1.10 Extraordinary Assumptions & Hypothetical Conditions

USPAP discloses in Standard 9f and 9g for the appraiser to disclose any and all extraordinary assumptions or hypothetical conditions necessary in the assignment. These may be used for purposes of reasonable analysis. Other than what has already been disclosed in the report, I have not used any material extraordinary assumptions or hypothetical conditions that would impact the value.

1.11 Principal Sources of Information

Principal sources of information used by the appraiser include one or more of the following:

- Financial statements (Tax Return) for subject Company for years 2006 to 2008.
- Other financial statements including interim / internal / compiled statements.
- Valuing a Business, Fourth Edition, Shannon Pratt, 2000.
- Valuing Small Businesses and Professional Practices, Third Edition, Shannon Pratt, 1998.
- Business Valuation Discounts and Premiums, Shannon Pratt, 2001.
- Understanding Business Valuation, Second Edition, Gary Trugman, 2002.
- Duff & Phelps, LLC Risk Premium Report 2009
- RMA Statements Studies, Valuation Edition, 2008-9.
- Revenue Ruling 59-60, US Internal Revenue Service, 1959.
- Pratt's Stats, BV Market Data, 2009.
- Bizcomps 2008, Jack Sanders, 2009.
- Economic Outlook Update, Business Valuation Resources, 2009.
- The Small Business Economy: A Report to the President 2008, Small Business Administration, 2009.
- State Economic Performance First Research©, 2009, updated as noted in the report.
- IBISWorld© Industry Reports & First Research©, 2009, updated as noted in the report.
- Local Economy – Economy.com / Various Local Websites / ESRIBIS.com.
- Information provided by buyer, seller and/or lender, either in writing or verbally.
- Other sources specified herein.

1.12 Assumptions & Limiting Conditions

1. The valuation process is not a finding of fact. It is a good faith finding of opinion. The opinion is supported by a reasonable amount of research and analysis, but is ultimately only the informed and unbiased judgment of the appraiser.

2. We have relied on management's representations without independent investigation as though they fairly and accurately represent the financial condition and activities of the Company.

3. Neither our engagement nor this report can be relied upon to disclose any fraud, misrepresentation, deviations from Generally Accepted Accounting Principles, or other errors or irregularities.

4. This report and appraisal are made for the purpose and function set forth above in the section entitled "Purpose and Use of the Appraisal", and its use for any other purpose invalidates the result of the appraisal.

5. This appraisal relies upon information provided by others and/or obtained from sources that are believed in good faith to be reliable. No opinion, warranty, or guaranty of the reliability of the data relied upon is implied or expressed by the use of that data here.

6. The estimate of Fair Market Value established by this report may rely on estimated values for some assets of the subject firm if independent appraisals for those assets are not available. Where such values are used in this appraisal, no warranty is made with respect to these values. If these

values are incorrect, the resulting estimate of the value of the subject ownership interest may be affected.

7. This appraisal is not a legal or tax opinion. Its purpose is to estimate value accordingly to the applicable standard of value. The appraiser assumes no responsibility whatsoever for legal or tax matters relative to its finding. Values are stated without reference to applicable legal or tax claims unless so noted.

8. Throughout this analysis, we may have relied upon the forecasts and projections of business activity and financial performance prepared by the client. We've examined these projections only at a gross level to test their fundamental reasonableness, but offer no opinion as to the reliability of these projections and forecasts.

9. We have no knowledge of issues related to litigation, regulatory compliance, environmental hazards, or other agreements about the owners or third parties, which would have a negative material impact on the value or transferability of the interest being valued unless otherwise noted in the report.

10. This report is not to be construed, directly or indirectly, as a recommendation to invest, divest, or to lend; it is strictly our independent opinion for the purpose described herein, based upon the information, explanations and materials provided to us and subject to the assumptions and qualifications noted herein. Potential investors and/or lenders should perform or obtain their own analysis of the Company's financial position for their particular purposes.

11. This report is not intended for general circulation or publication, nor may it be reproduced or used for any purpose other than that specifically noted herein, without our written permission in each specific instance. We do not assume any responsibility or liability for losses incurred by the Company, the directors, shareholders or owners thereof, or to other parties, as a result of the circulation, publication, production or use of this report contrary to the provisions of this paragraph.

12. We reserve the right to review all calculations included or referred to herein and to revise our opinion in the light of any facts, trends or changing conditions that existed at the valuation date of which we are made aware subsequent to the date hereof. However, we will not be under any obligation to do so, unless prior arrangements have been made in writing relative to such additional services.

13. In no way is GCF Valuation recommending a loan. Our opinion is strictly limited to the fair market value. It is agreed that the client does not hold the appraiser responsible in case of a loan default as this is an opinion of value and not an opinion to lend funds. It is also recommended that the lender and borrower obtain a second opinion to limit their liability or loss.

14. As indicated earlier, the appraiser was engaged subject to time and budget limitations. While the appraiser's research, process and analysis were both adequate and reasonable for the scope of the project, they were not unlimited in scope. The appraiser has assumed that all necessary licenses, leases, and other intangibles that are necessary to generate the level of income shown used in the valuation will transfer to the proposed buyer.

2.0 Summary Description of the Business & Industry

2.1 Summary Report Contents

As discussed earlier, I have been engaged to provide a summary report (vs. a self contained). A Summary Report is appropriate where, the intended readers of the report are already familiar with the pertinent features of the company, its markets, financial performance and the industry environment in which the Company operates. The contents of this report include only items that we feel are important to express the value of the subject business to the intended readers, who are assumed to have an advanced knowledge of Finance & Valuation. Although this report is not intended to meet replicability standards of a comprehensive report, our work file contains the necessary data to replicate our estimated value.

2.2 Form of Organization

The report assumes a Subchapter S Corporation taxation structure. The subject company is a closely held business and follows a tax strategy that shifts the burden of taxation from corporate rates to personal rates. Although, the subject company may have a different IRS filing structure, any normal entrepreneur would be expected to either continue the strategy of shifting taxable income to personal taxation rates or convert the Company into a Subchapter S Corporation.

2.3 History & General Description of the Business

XYZ Animal Hospital, P.C. was files as a corporation in the State of _____ 1981 even though its operations actually precede that date as it opened in 1977. The current owner has been the sole owner and single practitioner in the practice since its inception. The business has always provided veterinary services to companion animals. The Company is located in a retail/commercial/professional area on the southwestern side of _____ and the area is surrounded by numerous residential developments.

2.4 Prior Transactions

As of the valuation date, no prior transactions are known or were disclosed in my interview with the client or proposed buyer within the last 3 years. We have not appraised the subject company in the last three years.

2.5 Management & Staffing

This risk factor is assessed according to the degree of dependence upon the owner, or a key employee, for customer contact, daily operations and direct employee supervision. The more highly defined and developed the management structure, the lower the reliance on the entrepreneur for sales, operation & direct supervision, the lower the perceived risk. The more the entrepreneur acts in the capacity of senior management, the lower the risk of entrepreneurial change and the closer the company comes to the structure of a small publically traded company.

The company employs 12 individuals in various capacities including mid-level supervision and an outside sales staff. The current owner functions as the general manager.

2.6 Customers & Supplier Diversity

High customer concentration opens the business to an "enterprise threatening risk" should that customer be lost. Low customer concentration suggests a broad base of customers that may normally be cycled or replaced through a company's continuous marketing program, creating a lower risk.

Similarly, a high concentration of available sources for the company's product can create undue control over a small business' cost structure and overall profitability. A high concentration can result in an "enterprise threatening risk" with a sudden loss of the capacity to operate, with an abundance of suppliers creating lower risk. One of the key differences between Customer Diversity and Supplier Diversity is the availability of suppliers in the market. Just because a small business chooses to use a limited number of suppliers is not necessarily a higher risk.

The company does not have any concentration of business with a single customer or a small group of customers. It also has no concentration of its purchasing with any single vendor or small group of vendors as there are a large number of existing and willing suppliers that can provide the Company the inventory and supplies necessary to the practice. The lack of any concentration in these areas has a positive impact on the value of the subject company.

2.7 Facilities, Location and Equipment

The subject company operates from an approximate 6,000 ft.² office/warehouse located in the middle of the market served. The location is considered appropriate for the operation of the business and the business is not overly dependent upon the exact location to operate successfully The property is rented by a third party at an open market rate of rent; therefore, no adjustment for the FMV of rent made to the valuation cash flow model.

The owner of the business also controls the ownership of the property. The owner has been charging an above open market rental rate for the space occupied by the subject company. Therefore, I have adjusted the cash flow model to reflect the normalized fair market rent based on - an 8% capitalization rate of property's FMV. / - a rental survey conducted through loop lender.net. / - a FMV lease negotiated between the buyer & seller.

The company provides a service where operating assets consists mostly of office furniture and equipment leading to a low need for capital expenditures. The purchaser estimates that the shop is operating at 95% capacity. Must revamp technology constantly.

2.8 Competitive Pressures and Barriers to Entry

The value of a specific company is affected by the size and depth of the competition within their industry and local market. Higher barriers to entry including necessary equipment, certifications or qualified personnel will lower competition risk.

The subject company exhibits average rate of competition and a high barrier to entry. The industry has numerous local competitors and competes by servicing a niche market -- providing a more personalized service – close customer relationships on a local level developed over a lengthy operating history– maintaining a active targeted marketing campaign.

2.9 Future Prospects for the Business & Summary

The subject company has operated within the same community for the past 2 decades; therefore there isn't much in the way of growth or expansion unless additional locations in other cities occur. The subject company appears stable and consistent heading into the short term future.

3.0 Economic and Industry Factors Affecting the Company

3.1 Economy & Overall Impact on Business

Overview: One of the factors to consider specifically mentioned in the Revenue Ruling 59-60 is "the economic outlook in general and the condition and outlook of the specific industry in particular." Although individual economic factors may or may not have a direct impact on a particular industry or business, the overall economy (and the outlook for it) strongly influences the actions of investors and the assessment of investment opportunities. All businesses are impacted in some way by the economy.

I have examined the national, state and local economic reports available through various sources to create an informed opinion regarding the general direction and scope of the downstream demand determinants that influence the subject company. In general, the economy creates the environment within which the business must operate. It influences the size of the available market and company's growth potential.

The summary below provides an overview of some selected economic factors that prevailed in the 3rd quarter of 2009 as well as a discussion of the factors that are crucial over an extended period of time. The following narrative includes excerpts of the Economic Outlook Update™ 3Q 2009[5]. The full narrative is contained in our work files.

Overview of the Current U.S. Economy: The gross domestic product (GDP), the broadest measure of the U.S. economy, grew at a 3.5% annual rate in the third quarter of 2009. This was the first sign of growth since the second quarter of 2008 and was the largest quarterly growth since the third quarter of 2007. GDP growth this quarter was slightly better than some analysts had forecasted. Economists surveyed by Briefing.com had forecasted a 3.2% growth in GDP. The positive GDP report this quarter is one more sign that the economy has likely pulled out of the deep recession that started in 2007. Businesses continued to reduce inventories, but at a much slower rate. A rebound in auto sales—aided by the government's Consumer Assistance to Recycle and Save Act of 2009 (more commonly referred to as "Cash for Clunkers")—also provided a boost to the GDP. Motor vehicle output added 1.66 percentage points to the third-quarter change in real GDP after adding 0.19 percentage points to the second-quarter change. The economic stimulus package, with public works projects and aid to state and federal governments, helped boost growth as well. Consumer spending rose significantly this quarter, seeing a 3.4% growth. This was the biggest quarterly increase in nearly three years. Spending by consumers accounts for more than two-thirds of the nation's economic activity.

U.S. Economic Outlook: After four consecutive periods of economic contraction, GDP grew at an annual rate of 3.5% in the third quarter of 2009—the largest quarterly growth since the third quarter of 2007 and slightly above analysts' predictions who were surveyed by Briefing.com. The third-quarter GDP growth was largely attributed to government spending, increased consumer spending, increased exports, and increased residential fixed investment. Stocks continued to climb this quarter, with the major stock indexes posting double-digit gains. Research from the Center for Audit Quality shows that investor confidence is stabilizing after plunging from 2007 to 2008.

[5] "All of the contents of the economic outlook section of this valuation report are quoted from the *Economic Outlook Update™ 3Q 2009* published by Business Valuation Resources, LLC, © 2009, reprinted with permission. The editors and Business Valuation Resources, LLC, while considering the contents to be accurate as of the date of publication of the *Update*, take no responsibility for the information contained therein. Relation of this information to this valuation engagement is the sole responsibility of the author of this valuation report."

Tennessee Economic Overview: Tennessee to receive federal funds for technology upgrades in unemployment benefits processing and career training programs; job growth forecasted to begin Q2 2010 and steadily improve through 2012; property taxes among lowest in nation.[6]

- State job growth fell 4.0% in October 2009 from a year ago; national job growth fell 3.9%.
- State unemployment averaged 10.2% in October 2009; the national average was 9.8%
- Personal income fell 0.9% to $217 billion in Q2 2009 from a year ago.
- Tax revenue fell 11.4% in Q2 2009 from the previous year.
- Exports fell 19.2% to $10.9 billion in the first seven months of 2009 from a year ago.
- Venture capital investment in TN rose 13% to $11 million in Q2 2009 from a year ago.

Knoxville Economic Overview: From the Sperling's Best Places website, we extracted the following information on Knoxville's economy:

- As of 2009, Knoxville's population is 183,546 people. Since 2000, it has had a population growth of 4.86 percent.
- The median home cost in Knoxville is $109,640. Home appreciation the last year has been -3.30 percent.
- Compared to the rest of the country, Knoxville's cost of living is 19.73% lower than the U.S. average.
- Knoxville public schools spend $5,490 per student. The average school expenditure in the U.S. is $6,058. There are about 0 students per teacher in Knoxville.
- The unemployment rate in Knoxville is 11.40 percent (U.S. avg. is 8.50%). Recent job growth is Negative. Knoxville jobs have decreased by 4.60 percent.

Economy & Impact on Subject Business: The Company provides its services solely to the local market, particularly those clients that find the location convenient to their home or work location. For that reason, it is difficult to tie the Company's performance directly to the factors which contributed to the recession at the national level. However, reviewing the information for the state and local eoncomies (included above) it is obvious that many of the same factors are affecting those economies as well. IN Knoxville, home prices have dropped by more than 3% over the past year and unemployment has reached 11.4% where the national average is only 8.50%. These factors are likely to affect consumer spending which is named in the industry information as the primary risk to the performance projected of the industry as a whole. Given the Company's declining sales trend, we must assume there is some risk associated with its performance that is the result of the slowing local economy.

3.2 Industry & Overall Impact on Business

Overview. I have examined various sources available industry reports to create an informed opinion regarding the industry in terms of general composition, direction, competitive pressures, barriers to entry, projected growth, and its relevance to the subject company, if any.

The US veterinary services industry includes about 26,000 veterinary centers and animal testing laboratories, with combined annual revenue of $20 billion. VCA Antech and Banfield, located in PetSmart stores, are the largest operators of animal hospitals. VCA Antech also operates testing labs. The industry is highly fragmented: the 50 largest companies hold less than 10 percent of the market. The typical veterinary services company operates an animal hospital with less than 20 employees on staff and has annual revenue under $1 million.

[6] First Research, http://access.firstresearch.com, "State Profile Tennessee" September 2009

Growth Forecast: The output of US veterinary services is forecast to grow at an annual compounded rate of 8 percent between 2009 and 2014.7

- Demand: Medical advances drive demand
- Efficient use of labor required
- Risk: Slow economy limits spending on non-essentials

Demand & Cost Drivers: Changes in the economic environment that may positively or negatively affect industry growth.

- Consumer Spending: Change in overall level of consumer spending on goods and services.

Industry & Impact on Subject Business: The veterinary industry has been projected for high growth over the next five years in comparison to most other industries and it has shown relatively resistance to the slowing economy over the past 24 – 36 months. However, the subject has shown signs of a serious decline in revenues over the past 18 – 24 months and this performance could indicate the Company has a weakness more significant than most of the industry. Still, I believe the current issues with performance may be more related to the current owner and/or local economy than the result of any industry trend.

[7] First Research, http://access.firstresearch.com, "Industry Profile Veterinary Services" 9/14/2009

4.0 Financial Analysis of the Company

4.1 Financial Statements

Appraisers normally rely on two primary sources of financial information about a company:

1. Balance sheets depict the financial position or status of the company as of a specific date, and sent forth the assets and liabilities of the company.

2. Income statements describe the performance of the company in financial terms over a period of time, usually 12 consecutive months, but sometimes monthly or quarterly.

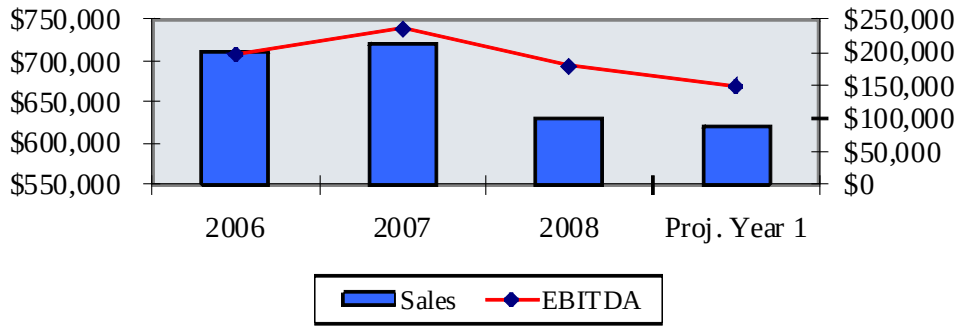
Financial statements reporting the financial condition and performance of the subject were provided to the appraiser in the form of the following:

Year	Type of Financial Statement
2006	Tax Return
2007	Tax Return
2008	Tax Return
9/30/2009	Internal (valuation date)

4.2 Revenue & Earnings History

The graph below summarizes the historical adjusted earnings performance of the Company.

Graph 4.2a
Adjusted Profitability Analysis



4.3 Financial Statement Analysis

Generally, the analysis of the company's financial statements, the income statements and balance sheets, is performed in order to assist the appraiser in measuring trends, identifying the assets and liabilities of the company, and in comparing the financial performance and condition of the company to other companies in the same or similar industry. This process is useful because it helps the valuator understand, evaluate, and communicate the value and risk drivers present in the company.

4.3.1 Analysis of the Balance Sheet

The analysis of the balance sheet includes: (i) an analysis of the most recent years of historical balance sheets to ascertain trends and any specific as to sets or liabilities for which comments would be helpful to understanding the valuation impact, (ii) a comparison of the subject's balance sheet with those of other firms in the same or similar industry. Industry averages have been obtained from Fintel Statements Studies –provided by First Research©. (The industry comparison analysis is presented in Section 4.3.3)

Table 4.3.1a
Historical Balance Sheet

December:	Tax Return 2006	%	Tax Return 2007	%	Tax Return 2008	%	Industry Ave.
Assets							
Cash & Equivalents	$0	0.0%	$0	0.0%	$78,704	60.3%	16.7%
Accounts Receivable	$0	0.0%	$0	0.0%	$0	0.0%	1.7%
Inventory	$0	0.0%	$0	0.0%	$0	0.0%	2.5%
Other Current Assets	$8,775	37.0%	$0	0.0%	$41,117	31.5%	23.1%
Total Current Assets	$8,775	37.0%	$17,544	57.8%	$119,821	91.7%	44.0%
Fixed Assets	$180,985		$180,985		$186,215		
Accum. Depreciation	($166,031)		($168,175)		($175,439)		
Net Fixed Assets	$14,954	63.0%	$12,810	42.2%	$10,776	8.3%	22.3%
Other Assets	$0	0.0%	$0	0.0%	$0	0.0%	54.5%
Total Assets	$23,729	100.0%	$30,354	100.0%	$130,597	100.0%	100.0%
Liabilities and Equity							
Accounts Payable	$0	0.0%	$0	0.0%	$0	0.0%	7.4%
Short-Term Debt	$0	0.0%	$0	0.0%	$0	0.0%	
Other Current Liab.	$26,342	111.0%	$48,359	159.3%	$170	0.1%	
Total Current Liabilities	$26,342	111.0%	$48,359	159.3%	$170	0.1%	27.7%
Total Long-Term Debt	$0	0.0%	$0	0.0%	$0	0.0%	9.3%
Shareholder Loans & Other	$0	0.0%	$0	0.0%	$0	0.0%	
Total Liabilities	$26,342	111.0%	$48,359	159.3%	$170	0.1%	37.0%
Owners' Equity	($2,613)	-11.0%	($18,005)	-59.3%	$130,427	99.9%	63.0%
Liabilities & Equity	$23,729	100.0%	$30,354	100.0%	$130,597	100.0%	100.0%

Analysis: The balance sheet shows rather sparse accounting throughout the three years included here. While most years include only other assets (or no assets), the 2008 tax return did include cash and other current assets. The cash position is significant and makes up slightly more than 60% of total assets. Other assets were loans to shareholders and are not usually classified as current assets. The Company's fixed asset position has changed little over the past three years and accumulated depreciation leaves the net fixed asset values at insignificant dollar amounts in all three years. Equally sparse are the Company's liabilities which total less than $200 and are all listed under other current liabilities. Of course, the lack of debt allows the Company a superior working capital position and an owners' equity position high above the industry average.

4.3.2 Analysis of the Income Statement

The purpose and use of analyzing the income statements are analogous to the explanation of the analysis of the balance sheets. Using a common size format, we will analyze the income statement for trends and compare it to its industry. This allows year-to-year comparisons and reveals the relationships between certain expenses as a percentage of total sales.

Table 4.3.2a
Historical Income Statement - Unadjusted

December:	Tax Return 2006	%	Tax Return 2007	%	Tax Return 2008	%	Industry Ave.
Gross Revenue	$710,955	100.0%	$721,160	100.0%	$629,603	100.0%	100.0%
Cost of Sales	$161,325	22.7%	$142,624	19.8%	$174,672	27.7%	50.1%
Gross Profit	$549,630	77.3%	$578,536	80.2%	$454,931	72.3%	49.9%
Operating Expenses							
Officer's salary	$360,000	50.6%	$360,000	49.9%	$120,000	19.1%	
Salaries & wages	$16,920	2.4%	$9,405	1.3%	$52,648	8.4%	
Repairs & maint.	$7,763	1.1%	$2,903	0.4%	$2,425	0.4%	
Bad debts	$0	0.0%	$0	0.0%	$0	0.0%	
Rents	$60,000	8.4%	$60,000	8.3%	$60,000	9.5%	
Taxes & licenses	$36,109	5.1%	$36,288	5.0%	$14,648	2.3%	
Interest	$0	0.0%	$0	0.0%	$0	0.0%	
Dep. & amort.	$2,433	0.3%	$2,144	0.3%	$49,498	7.9%	
Advertising	$818	0.1%	$660	0.1%	$1,047	0.2%	
Pension	$88,000	12.4%	$90,000	12.5%	$0	0.0%	
Employee benefits	$0	0.0%	$0	0.0%	$0	0.0%	
Other deductions	$39,658	5.6%	$37,127	5.1%	$48,683	7.7%	
Total Operating Exp.	$611,701	86.0%	$598,527	83.0%	$348,949	55.4%	
Other Income/Expense							
Other Income	$5,496	0.8%	$4,652	0.6%	$266	0.0%	
Other Expense(-)	$0	0.0%	$0	0.0%	$0	0.0%	
Total Other Inc/Exp.	$5,496	0.8%	$4,652	0.6%	$266	0.0%	
Pre-Tax Profit	($56,575)	-8.0%	($15,339)	-2.1%	$106,248	16.9%	6.1%
Income Taxes	$0	0.0%	$0	0.0%	$0	0.0%	
After-Tax Profit	($56,575)	-8.0%	($15,339)	-2.1%	$106,248	16.9%	3.2%

Analysis: While the Company was able to show some slight growth in the period from 2006 to 2007, sales began to decline significantly in 2008. Cost of sales also rose considerably in the year ending in 2008 and reduced gross profits to only 72.3%, still well above the industry average. However, as sales dropped, the officer also significantly reduced his own compensation but salaries and wages increased. Still, the overall effect decreased operating expenses and allowed the Company to show its highest level of pre-tax profits of any of the three years shown above.

4.3.2.1 Interim or Year to Date Income Statement

Interim statements, also known as year to date statements, can be used to show how the subject Company is performing mid-year. These statements may or may not show a consistent trend because certain revenues and expenses may be classified differently or posted at different times during the year. Although the statement should be considered, they should not be relied on as "final" or "year ended". The interim statements given to the appraiser are shown as follows:

Table 4.3.2.1a
Year to Date Income Statement Analysis

	Internal 9/30/2009	%	Internal 10/31/2008	%	% Inc./Dec.
Gross Revenue	$365,819	100.0%	$0	NA	NA
Cost of Sales	$0	0.0%	$0	NA	NA
Gross Profit	$365,819	100.0%	$0	NA	NA
Operating Expenses					
Officer's salary	$0	0.0%	$0	NA	NA
Salaries & wages	$9,888	2.7%	$0	NA	NA
Repairs & maint.	$1,413	0.4%	$0	NA	NA
Bad debts	$0	0.0%	$0	NA	NA
Rents	$0	0.0%	$0	NA	NA
Taxes & licenses	$2,770	0.8%	$0	NA	NA
Interest	$0	0.0%	$0	NA	NA
Dep. & amort.	$1,262	0.3%	$0	NA	NA
Advertising	$1,071	0.3%	$0	NA	NA
Pension/profit-sharing	$0	0.0%	$0	NA	NA
Employee benefits	$0	0.0%	$0	NA	NA
Other deductions	$81,629	22.3%	$0	NA	NA
Total Operating Exp.	$98,033	26.8%	$0	NA	NA
Other Income/Expense					
Other Income	$0	0.0%	$0	NA	NA
Other Expense(-)	$0	0.0%	$0	NA	NA
Total Other Inc/Exp.	$0	0.0%	$0	NA	NA
Pre-Tax Profit	$267,786	73.2%	$0	NA	NA

Analysis: Since there were no comparable interim statements for the period ending September 30, 2008, no trend analysis is possible. It appears the Company's performance has increased inordinately as there is no cost of sales, no officer's salary and no rents included in the expenses. The lack of these substantial items gives the Company the appearance of an unusual level of pre-tax profits that could not be expected to survive year end accruals or accounting adjustments.

4.3.3 Industry Comparison Ratio Analysis

It is common practice to have the financial analysis include a comparison of the company's liquidity, operating, financial and profitability ratios calculated over several years for trend analysis and to be used to compare to the ratios for the industry. This comparison is best used when the subject can be compared to companies in the same or a similar industry. The information about companies operating in the same general business environment are often identified and sorted by the Standard Industrial Classification (SIC) code or North American Industry Classification System (NAICS) code for their industry.

A number of sources for these industry norms are available, but one in particular is used by a number of business appraisers – Fintel. The Fintel data obtained has been used under a license agreement issued by First Research.[8] The source for the comparative information is shown on the following page:

[8] Financial industry data provided by Fintel -- offering leading benchmarking with a database of over 900 industries. Utilize financial analysis through profitability, liquidity, sustainable growth rate, business valuation, custom research, and other tools. www.fintel.us/firstresearch© Copyright 2007, First Research, Inc. All Rights Reserved.

Table 4.3.3a
First Research / Fintel Information

Veterinary Services - (NAICS: 54194)

12 Month Rolling Data Period	Last Update September 2009
Small Company Data	Sales < $776,926
Table Data Format	Median Values

	US Private Company Data	
	Aggregate	Company
Company Count in Analysis	48	3 Yr. Ave.
Income Statement		
Net Sales	*100.0%*	*100.0%*
Gross Profit	49.9%	76.6%
Operating Income	6.1%	4.6%
Net Profit After Tax	3.2%	2.3%
Balance Sheet		
Cash	16.7%	20.1%
Accounts Receivable	1.7%	0.0%
Inventory	2.5%	0.0%
Total Current Assets	23.1%	62.2%
Total Fixed Assets	22.3%	37.8%
Other Non-Current Assets	54.5%	0.0%
Total Assets	100.0%	*100.0%*
Accounts Payable	7.4%	0.0%
Total Current Liabilities	27.7%	90.2%
Total Long-Term Liabilities	9.3%	0.0%
Net Worth	63.0%	9.8%
Financial Ratios		
Quick Ratio	0.9	154.3
Current Ratio	1.5	235.2
Current Liabilities to Net Worth	35.0%	-425.5%
Current Liabilities to Inventory	282.0%	NA
Total Liabilities to Net Worth	77.0%	-425.5%
Fixed Assets to Net Worth	39.0%	-211.7%
Collection Period	3.5	0.0
Inventory Turnover	36.9	NA
Assets to Sales	28.0%	5.1%
Sales to Working Capital	8.4	-0.1
Accounts Payable to Sales	3.0%	0.0%
Return on Sales	3.0%	26.8%
Return on Assets	7.5%	562.4%
Return on Investment	37.0%	-2875.9%
Interest Coverage	8.7	NA

4.3.3.1 Key Liquidity Ratios

Table 4.3.3.1a
Liquidity Ratios Vs. Peer Group - Historical

	3-Year Average	Last Full Year	Fintel Industry-Ave.
Current Ratio	235.2	704.8	1.5
Quick Ratio	154.3	463.0	0.9

Current Ratio: This ratio is calculated by dividing total current assets by total current liabilities. This is a general indication of the extent to which claims of short-term creditors are covered by assets that are expected to be converted into cash in a period that roughly corresponds to the due dates of the current liabilities. In general, the higher the ratio the greater the cushion between current obligations and the firm's ability to pay them is considered to exist. Based on the analysis shown above, the subject's average current ratio of 235.2 is higher than the industry average of 1.5.

Quick Ratio: This ratio is calculated by adding cash to trade receivables and dividing by total current liabilities. Also known as the "acid test" ratio, this is a stricter, more conservative measure of liquidity than the current ratio. This ratio reflects the degree to which a company's current liabilities are covered by its most liquid current assets, the kind of assets that can be converted to cash and at amounts close to book value. Inventory and other less current assets are removed from the calculation Generally, if the ratio produces a value that's less than 1 to 1, it implies a "dependency" on inventory or other "less" current assets to liquidate short term debt. Based on the analysis shown above, the subject's average quick ratio of 154.3 is higher than the industry average of 0.9.

4.3.3.2 Key Working Capital / Turnover Ratios

Table 4.3.3.2a
Turnover Ratios Vs. Peer Group - Historical

	3-Year Average	Last Full Year	Fintel Industry-Ave.
Sales / Receivables	NA	NA	104.3
Days' Receivables	NA	NA	3.5
Inventory Turnover	NA	NA	36.9
Sales / Working Capital	-19.5	5.3	8.4

Sales / Receivables: This ratio is calculated by dividing net sales by trade receivables and measures the number of times trade receivables turn over during the year. This ratio is interpreted as, the higher the turnover of receivables, the shorter the time between sale and cash collection. A problem with this ratio is that it compares one day's receivables, shown at statement date, to total annual sales and does not take into consideration seasonal fluctuations. Based on the analysis shown above, the subject's average Sales to Receivables Ratio of NA is NA than the industry average of 104.3.

Days' Receivables: This figure is calculated by dividing the sales / receivable ratio into 365 (the number of days in one year). It expresses the average number of days that receivables are outstanding. Generally, the greater the number of days outstanding, the greater the probability of delinquencies in accounts

receivable. Based on the analysis shown above, the subject collects their receivables an average of NA days, which is NA than the industry average of 3.5.

Cost of Sales to Inventory: Also known as inventory turnover, this ratio is calculated by dividing cost of sales by inventory and measures the number of times inventory is turned over during the year. On the positive side, high inventory turnover can indicate greater liquidity or superior merchandising. However, it can indicate a shortage of needed inventory for sales. Low inventory turnover can indicate poor liquidity, possibly overstocking, or obsolescence. Similar to the Sales / Receivables ratio, inventory turnover only compares one day's inventory to cost of goods sold and does not take into consideration seasonal fluctuations. Based on the analysis shown above, the subject's inventory turns over NA times per year, which is NA than the industry average of 36.9.

Sales / Working Capital: This ratio is calculated by dividing net sales by working capital. This ratio measures how efficiently working capital is being used and many times can be misleading. Usually, the lowest positive ratio is considered "good" and the lowest negative ratio is considered "bad". Based on the analysis shown above, the subject's Sales / Working Capital ratio of -19.5 is lower than the industry average of 8.4.

4.3.3.3 Key Debt Ratios

Table 4.3.3.3a
Debt Ratios Vs. Peer Group - Historical

	3-Year Average	Last Full Year	Fintel Industry-Ave.
Fixed Assets / Net Worth	-2.1	0.1	0.4
Debt / Net Worth	0.0	0.0	0.8

Fixed Assets / Net Worth: This ratio measures the extent to which owner's equity (capital) has been invested in plant and equipment (fixed assets). A lower ratio indicates a proportionately smaller investment in fixed assets in relation to net worth and a better "cushion" for creditors in case of liquidation. Similarly, a higher ratio would indicate the opposite situation. Based on the analysis shown above, the subject's Fixed Asset / Net Worth ratio of -2.1 is lower than the industry average of 0.4.

Debt / Net Worth: This ratio expresses the relationship between capital contributed by creditors and that contributed by owners. Basically, it shows how much protection the owners are providing creditors. The higher the ratio, the greater the risk being assumed by creditors. A lower ratio generally indicates greater long-term financial safety. Based on the analysis shown above, the subject's Debt / Net Worth ratio of 0.0 is lower than the industry average of 0.8.

4.3.3.4 Conclusion and Implication for the Company

The reader should not try to draw too much importance from slight deviations from the industry statistics for the following reasons: (1) the industry data isn't always representative of the typical firm in the industry. (2) It is normal and not an indication of trouble to have variation from company to company, even within the same industry.

As may have been surmised in the analysis of the balance sheet above, nothing in the industry data or the internal trend analysis have disclosed problems sufficient to cause me to recognize an unusual level of risk. It appears the Subject Company is operating at or above industry averages in most areas.

4.4 Adjustments to Financial Statements

The process of estimating the value of a business or business interest frequently requires the adjustment of certain financial statements to free them form the influence of accounting elections that were made to minimize tax liability; and to restate them in such a way as to depict the true economic performance and condition of the company.

These adjustments are most frequently made when the following two conditions are met:

- For all adjustments when information is available which would allow the adjustment to reflect a truer picture of the economic performance or condition of the company, and
- For adjustments relating to control, when the subject ownership interest has the ability to cause such adjustments to be made.

I'm valuing a controlling interest basis; therefore, adjustments that require control are appropriate. Adjustments to the balance sheet and income statements are considered in the following Sections.

4.4.1 Adjustments to the Balance Sheet

General: Adjustments to the balance sheets are usually intended to re-state asset and liability entries from book value to their fair market value on or about the date of valuation. Although I have not made any adjustments for the historical statements, I did adjust the balance sheet as of the date of the valuation. The bases for key adjustments and assumptions are shown below:

Current Assets: Cash, A/R and other current assets have been eliminated, as these items are not included in the proposed sale. Inventory was included at book value.

Fixed Assets: Fixed assets have been normalized to include only the operating assets of the company not including any real estate. Fixed assets have been estimated to have a fair market value of $96,282, which is based on 50% of the original book value of those assets and believe to represent a reasonable estimate of fair market value. To our knowledge the fixed assets have not been independently appraised.

Other Assets: Other assets have been eliminated from the latest balance sheet, as these items are not included in the proposed sale.

Current Liabilities: Current liabilities have been eliminated from the latest balance sheet, as liabilities are not to be assumed in the proposed transaction.

Long-term Liabilities: Long-term liabilities have been eliminated from the latest balance sheet, as liabilities are not to be assumed in the proposed transaction.

As shown below, I have adjusted the balance sheet as of 9/30/2009 and then allocated the amount that is included in the sale. The adjustments are shown below:

Table 4.4.1a
Adjusted Book Value

	Internal 9/30/2009	Adjusted Book Value	Included in Value	$ Included in Value
Assets				
Cash & Equivalents	$252,939	$252,939	No	$0
Less: Excess Cash	-	($150,000)	No	$0
Accounts Receivable	$0	$0	No	$0
Inventory	$0	$0	Yes	$0
Less: Excess Inventory	-	$0	Yes	$0
Other Current Assets	$135,818	$0	No	$0
Total Current Assets	$388,757	$102,939		$0
Fixed Assets	$192,563			
Accum. Depreciation	($183,049)			
Net Fixed Assets	$9,514	$96,282	Yes	$96,282
Other Assets	$0	$0	No	$0
Total Assets	$398,271	$199,221		$96,282
Liabilities and Equity				
Accounts Payable	$0	$0	No	$0
Short-Term Debt	$0	$0	No	$0
Other Current Liab.	$58	$58	No	$0
Total Current Liabilities	$58	$58		$0
Total Long-Term Debt	$0	$0	No	$0
Shareholder Loans & Other	$0	$0	No	$0
Total Liabilities	$58	$58		$0
Owners' Equity	$398,213	$199,163		$96,282
Liabilities & Equity	$398,271	$199,221		$96,282

4.4.2 Adjustments to Profit & Loss Statements

General: Typically when the control portion of a company is being valued, adjustments to the profit & loss statement are made to reflect economic reality rather than simply using statements prepared for income tax or financial reporting requirements.[9] Since I'm valuing a controlling interest, I have made certain adjustments shown on the following page:

[9] Jay E. Fishman, Shannon P. Pratt, J. Clifford Griffith, and D. Keith Wilson. Guide to Business Valuations. (Fort Worth: Practitioners Publishing Company, 1999) Ninth Edition, Volume 1, p. 4-19.

Table 4.4.2a
Adjusted Cash Flow Analysis

December:	Tax Return 2006	Tax Return 2007	Tax Return 2008	Projected 2009
Revenue				
Gross Sales	$710,955	$721,160	$629,603	$487,759
Sales Adjustment	$0	$0	$0	$0
Adjusted Sales	$710,955	$721,160	$629,603	$487,759
Cost of Goods Sold				
Historical Cost of Goods Sold	$161,325	$142,624	$174,672	$114,248
COGS Adjustment	$0	$0	$0	$0
Adjusted COGS	$161,325	$142,624	$174,672	$114,248
Cash Flow Adjustments				
Interest expense	$0	$0	$0	$0
Depreciation/Amort.	$2,433	$2,144	$49,498	$1,683
Officer compensation	$360,000	$360,000	$120,000	$120,000
Other add-backs	$0	$0	$0	$0
Other add-backs	$0	$0	$0	$0
Other add-backs	$0	$0	$0	$0
Other add-backs	$0	$0	$0	$0
Other add-backs	$0	$0	$0	$0
Other add-backs	$0	$0	$0	$0
Historical rent	$0	$0	$0	$0
Fair market rent	$0	$0	$0	$0
Total Add Backs	$362,433	$362,144	$169,498	$121,683
Cash Flow Calc.				
Pre-Tax Profit +	($56,575)	($15,339)	$106,248	$11,023
Total Adjustments =	$362,433	$362,144	$169,498	$121,683
Seller's Discretionary Earnings	$305,858	$346,805	$275,746	$132,706
Less Replacement Salary	($109,320)	($110,889)	($96,811)	($75,000)
EBITDA	$196,538	$235,916	$178,935	$57,706
as % of Sales	27.64%	32.71%	28.42%	11.83%

Note 1 – We have adjusted Officer compensation in the projections for 2009 to $75,000 per year which was taken from the Lender's presentation as a replacement salary for the new Buyer/Borrower. This amount is slightly below the industry average as reported by the Department of Labor, but is believed to be a reasonable estimate of fair market compensation for a practice of this type and size.

4.5 Notes to Adjustments

The above adjustments were given by outside parties and assumed to be correct. We assume that the adjustments are either at the owner's discretion or non-recurring. We also assume that each adjustment has actually been expensed from the financial statement being used in this analysis. We reserve the right to make adjustments to the valuation based upon consideration of additional or more reliable data that may become available subsequent to the issuance of this report.

4.6 Financial Forecast

According to Internal Revenue Service Revenue Ruling 59-60, "valuation … is, in essence, a prophecy as to the future and must be based on facts available at the required date of appraisal."[10] A company's value is based on its expected future earnings.

I have prepared projections for the next five years and have relied upon the following:

- Discussions with prospective purchaser, Paul Jeter
- Historical income statements
- Historical balance sheets
- RMA Valuation Edition – comparative ratios and common size analysis
- Industry forecast from IBIS World
- Interim P&L Statements 9/30/2009

Several methods exist for developing projections including the following:

1. Reliance upon buyer or seller projections;
2. Using regression analysis;
3. Using a historical average or weighted average approach;
4. Appraiser developed projections.

The most widely used is relying on historical figures and using an average or "weighted" average, which would represent a projection. This method is used frequently not only because of its ease of use, but because most buyers of smaller businesses will rely on historical performance to help project future performance. Because I'm valuing a smaller business, a buyer, seller and lender are most likely going to rely on historical statements to better judge ongoing profitability. Therefore, I've relied upon a weighted average.

My weights, assumptions and calculations are shown on the following page:

[10] Internal Revenue Service, *Revenue Ruling 59-60*, Section 3. Approach to Valuation.

Table 4.6a
Projected Cash Flow Analysis

December:	Projected 2009	Tax Return 2008	Tax Return 2007	Tax Return 2006
Adjusted Sales	$487,759	$629,603	$721,160	$710,955
Adjusted SDE	$132,706	$275,746	$346,805	$305,858
Adjusted EBITDA	$57,706	$178,935	$235,916	$196,538
Adjusted EBIT	$56,023	$129,437	$233,772	$194,105
Weight	40%	30%	20%	10%

Weighted Sales	$599,312
Sustainable Growth	3.5%
Projected Sales	$620,288
Weighted SDE	$235,753
Sustainable Growth	3.5%
Projected SDE	$244,004
Weighted EBITDA	$143,600
Sustainable Growth	3.5%
Projected EBITDA	$148,626
Weighted EBIT	$127,406
Sustainable Growth	3.5%
Projected EBIT	$131,865

Notes on Weighting: Weighting is reasonable when the appraiser concludes the return of any one or more years is a more reliable indicator of future returns than are the returns of the other years. Usually, a buyer of a small business will rely on the latest year or years or even the trailing 12 months. For the subject Company I have decided to give most weight to the projections for the year ending 2009.

Notes on Growth Rate: To the weighted average I have added a growth rate to arrive at next year's projection. Since I believe that growth will be relatively stable, this would be considered a sustainable growth rate. Based on my discussions with the client and parties involved, my analysis on historical performance, and the industry growth and outlook, it's my opinion that the sustainable growth going forward will be approximately 3.5%.

5.0 Valuation of the Subject Interest

5.1 Appraisal Concepts

The equity being valued will be valued on what is commonly referred to as a "going concern". This means that it is assumed that the company will continue in business and will be valued as an operating company.

According to IRS Revenue Ruling 59-60, "A determination of fair market value … will depend upon the circumstances in each case."[11] It also states that there is no one formula that works for each company. It further states that, "valuation is not an exact science. A sound valuation will be based upon relevant facts, but the elements of common sense, informed judgment and reasonableness must enter into the process…"[12] The revenue ruling goes on to suggest at least eight factors which should be considered:

1. The nature of the business and the history of the enterprise from its inception. This factor is summarized in Section 2 *Analysis of the Subject Company*.

2. The economic outlook in general and the condition and outlook of the specific industry in particular. This factor is summarized in Section 3 *Economic and Industry Factors Affecting the Company.*

3. The book value of the stock and the financial condition of the business. This factor is summarized in Section 4 *Financial Analysis of the Company.*

4. The earnings capacity of the company. This factor is summarized in Section 4 *Financial Analysis of the Company.*

5. The dividend-paying capacity. This factor is discussed in Section 4 *Financial Analysis of the Company.*

6. Whether or not the enterprise has goodwill or intangible value. This factor is discussed in Section 5 *Valuation of the Subject Interest.*

7. Sales of stock and the size of the block of stock to be valued. This factor is discussed in Section 1.1 *Subject of the Appraisal* and Section 2 *Prior Transactions of the Subject Interest.*

8. 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. This factor is discussed in Sections 5.52 and 5.62 *Application of the Market Approach.*

The Uniform Standards of Professional Appraisal Practice (USPAP) require business appraisers to "include in the analyses, when relevant, data regarding" the same eight factors referenced above from IRS Revenue Ruling 59-60.

[11] Internal Revenue Service, Revenue Ruling 59-60, Sec. 4. Factors to Consider.
[12] Internal Revenue Service, Revenue Ruling 59-60, Sec. 4. Factors to Consider.

5.2 Valuation Methods Considered But Rejected

The following methods were considered, but rejected for this appraisal:

5.2.1 Adjusted Book Value Method & Liquidation Value Method

Methods from the Asset Approach are often appropriate in the following situations:

- The company is considering liquidating or going out of business;
- The company has no earnings history;
- The company's earnings cannot be reliably estimated;
- The company depends heavily on competitive contracts and there is not consistent, predictable customer base (e.g., construction companies);
- The company derives little or no value from labor or intangible assets (e.g., real estate or holding companies);
- A significant portion of the company's assets are composed of liquid assets or other investments (e.g., marketable securities, real estate, mineral rights).

In spite of the fact that the Company has some investment in tangible assets, I believe that an investor would evaluate XYZ Animal Hospital based primarily upon the aggregate earnings and cash flow generating capability of the Company's combined assets, rather than based on individual asset values. Therefore, we have not employed the Adjusted Book Value Method or Liquidation Value Method in our analysis.

Although we have rejected the Adjusted Book Value Method in our determination of value for the subject Company, I have, however adjusted the Company's latest balance sheet as of 9/30/2009, which was shown in Section 4.4.1a.

5.2.2 Guideline Public Company Method

The Guideline Public Company Method involves analyzing similar or "comparable" public companies and using the stock prices of these companies to determine valuation multiples that can be applied to the company being appraised. Although I have considered this approach and there are a number of publicly held companies meeting my initial search criteria, none of the companies could be considered strong "comparables". First, the companies do not bear sufficiently strong similarities to the subject Company. Second, the guideline companies are much larger and have better access to capital. For these reasons, I've concluded that this method cannot yield a meaningful indication of value for the subject.

5.2.3 Multi-Period Discount Method

The Multi-Period Discount Method or Discounted Cash Flow Method is based on the amount an investor would be willing to pay today for the right to receive a certain amount of cash flow in the future. This method is often used when projected cash flows are expected to be uneven because of irregular growth or

other factors. As shown in Section 5.3.2 and Section 5.4.3, the Company's growth has been relatively stable over the last 3 years. I have projected sales and profit to remain stable and therefore, cash flows are projected to remain consistent. Since cash flows are projected to remain consistent, I have decided not to use the Multi-Period Discount Method.

5.2.4 Other Methods Considered But Rejected

Public Company Transactions Method: This method relies upon acquisitions of companies by public companies in the same or similar industry. Since the guideline company search did not reveal enough possible guideline companies for use in this appraisal, this method involving transactions in similar public companies was also not applicable.

Rules of Thumb: This method relies upon industry "guidelines" or rules of thumb and is usually used to verify the reasonableness of the final estimate of value. There are a number of rules of thumb for this industry, which will be used as a "sanity check" at the end of the report.

Past Transactions: Prior transactions of actual stock can be useful in determining fair market value if the transactions were made on an arm's length basis. As discussed in Section 2, no prior transactions have occurred since inception that would be considered reliable or would have a material impact on value. Due to the lack of prior known transactions and detail, this method could not be used.

Excess Earnings Method: The Excess Earnings Method can be classified as either an Income or Asset approach and is often called a "hybrid" method. The concept of the Excess Earnings Method is to develop a market value for a business wherein the values attributable to the tangible assets and the intangible assets are separately identified. First, a business should provide sufficient earnings to support the investment in the tangible assets necessary to operate the business. Any earnings in excess of the amount needed to support the tangible assets must then be attributable to the intangible assets. However, Revenue Ruling 68-609 states, "The formula approach may be used for determining the fair market value of intangible assets of a business only if there is no better basis therefore available." Since this method requires many subjective variables and I believe there are better methods, I have not used this approach.

5.3 Valuation Methods Selected

The choice of valuation methods to be used in a given appraisal assignment is a judgment by the appraiser. My choice of methods was determined by the characteristics of the business, the availability and reliability of the information related to the various methods and the function and use of the appraisal. After considering the methods rejected above, I selected the following methods as most likely to yield meaningful indications of value for the subject Company:

- Asset Approach – no methods selected;
- Market Approach – Direct Market Data Method (DMDM);
- Income Approach – Capitalization of Free Cash Flow & Capitalization of Seller's Discretionary Earnings (also known as SDE or Owner's Benefit).

5.3.1 Application of the Market Approach – Direct Market Data Method

The Direct Market Data Method, DMDM, develops a value based on the transaction values for which similar privately held businesses have been sold.[13] The method assumes that if you take a large group of transactions of similarly structured businesses, the central tendency of the value ratios in such groups represents the value determined in a free and open market or Fair Market Value. The size of the group has been demonstrated to require more than five transactions.[14]

5.3.1.1 Conceptual Basis

The DMDM relies on actual transactions involving the sale of ownership interests in businesses in the same, or similar line of business. The sales of these business interests usually include the sale of a 100% interest in a privately-held company. Database sources such as Institute of Business Appraisers, Bizcomps and Pratt's Stats are common sources of transactional data. Once comparable transactions are found, the data is analyzed and evaluated for its dependability and then applied to the comparable income streams of the subject business.

Each database reports its transaction price on a different set of assumptions. When applying the DMDM to each, certain adjustments will have to be made for assets and/or liabilities to be included in the valuation. However, one area that all of the databases have in common is the type of earnings stream to apply. According to Raymond C. Miles (MCBA, FIBA, ASA), the developer of this appraisal method, "The transactions that make up the IBA Market Data Base reflect prices that were paid by buyer based in part on the buyer's expectations with regard to the future of the business". ….." When using the Transaction Data Method as when using any other method of valuation, the future performance (revenue or earnings) should be forecast before applying the performance ratio that is to be used in estimating value."[15]

The Price to Earnings and Price to Sales ratio of closely held businesses show virtually no correlation with the date of the sale. These ratios tend to be consistent over time; therefore, comparable sales that may be decades old may still be valid for comparison purposes. There was no correlation found between down payment and these value ratios. However, a study which divided businesses by annual sales into intervals clearly showed that the larger the sales volume, the higher the Price to Earnings multiple.[16]

I have used the following databases for the DMDM approach: (1) **IBA Database** – the IBA database is the largest database with over 20,000 transactions. The average business represented in the database generates less than $1 million in annual sales with the data being collected primarily by business brokers. (2) **Bizcomps** – with data also collected by business brokers, this database is published by John Wiley & Sons and contains over 7,000 transactions with the average sales price of $270,000. (3) **Pratt's Stats** – this database is maintained by Business Valuation Resources and has over 7,300 transactions with the average market value of invested capital (MVIC) or "enterprise value" being $23 million. (4) **PeerComps** – the PeerComps database was published in 2009 (by GCF Valuation) and contains over 5,000 transactions. The information was gathered from SBA lenders and involves transactions specifically financed by the SBA. The summary of the databases are finding on the next 3 consecutive pages:

[13] Using Transaction Data to Value Closely Held Businesses, Institute of Business Appraisers, 1995.
[14] Ray Miles, How to Use the IBA Market Data Base, Part VII, How Many Guideline Transactions are Needed? (Plantation, FL: Institute of Business Appraisers, 1995)
[15] Raymond C. Miles, Technical Studies of the IBA Transaction Database. (Plantation, FL: The Institute of Business Appraisers, Inc., 2002), from "How to Use the IBA Market Database, Park XVIII, Interpreting Transaction Parameters, page 4.)
[16] Significant Studies Related to IBA Database – Institute of Business Appraisers – Tutorial Index.

5.3.1.2 IBA Market Data

An initial search of the IBA Market Comparison Data produced 30 transactions for SIC Code 742 with median revenues of $290,000.[17] The comparable transactions in detail have been kept in our work file. A summary of the data is presented below:

Table 5.3.1.2a
Market Approach - DMDM
IBA Market Data - Summary

	Annual Sales	Annual DE	Sale Price	SP / Sales	SP / DE	DE %
High	$1,031,000	$163,000	$850,000	1.26	15.60	60%
Top 10%	$634,300	$148,000	$409,500	0.95	5.10	43%
Top 25%	$405,750	$120,500	$300,000	0.82	3.58	29%
Mean	$344,967	$83,958	$244,400	0.71	3.37	21%
Median	$290,000	$76,500	$212,500	0.69	2.83	19%
Low 25%	$214,250	$39,250	$115,000	0.62	2.08	16%
Low 10%	$111,700	$29,300	$69,500	0.42	1.61	0%
Low	$75,000	$12,000	$25,000	0.19	0.99	0%
Coefficient of Variance				0.33	0.85	
Subject Company	$599,312	$224,018				37%

Mean, Median or Other Selected Selected	Top 25% 0.82	Top 25% 3.58

SIC Code Searched	742
Number of Transactions	30

As shown on the previous page, I broke the set of comparable sales down even further into high, low, mean and median. I also broke down the top and bottom percentiles and quartiles (10% and 25%). It appears that the subject Company is closest to the "Top 10%" in revenue, "High" in discretionary earnings and "Top 10%" in discretionary earnings as a percentage of sales. Based on this analysis, I believe that the subject Company should be classified by the "Top 25%" for the price to revenue multiplier and "Top 25%" for the price to discretionary earnings multiplier.

Other Notes: Comparing the Company's results to the quartiles arranged from the IBA database showed only slight variation in the upper quartiles and were closest to the High or Top 10% categories. Despite these results, my concern regarding the Company's declining revenues prompted me to use a more conservative set of multipliers from the Top 25% category.

[17] Institute of Business Appraisers, Market Comparison Data

5.3.1.3 Bizcomps Data

An initial search of the Bizcomps database produced 15 transactions for NAICS or SIC Code 742 with median revenues of $242,000.[18] The comparable transactions in detail have been kept in our work file. A summary of the data is presented below:

Table 5.3.1.3a
Market Approach - DMDM
Bizcomps Data - Summary

	Annual Sales	Discretionary Earnings	Sale Price	SP / Sales	SP / SDE	SDE %
High	$1,000,000	$228,000	$800,000	1.24	4.84	53%
Top 10%	$651,600	$131,600	$373,800	0.81	3.62	43%
Top 25%	$494,000	$121,500	$285,000	0.75	3.48	25%
Mean	$360,467	$85,133	$228,533	0.64	2.72	25%
Median	$242,000	$70,000	$189,000	0.64	2.96	23%
Low 25%	$210,500	$47,500	$123,000	0.54	1.89	18%
Low 10%	$126,000	$29,200	$67,000	0.37	1.35	16%
Low	$75,000	$12,000	$25,000	0.19	1.00	16%
Coefficient of Variance				0.38	0.39	
Subject Company	$599,312	$235,753				39%
Mean, Median or Other Selected Selected				Top 25% 0.75	Top 25% 3.48	

NAICS / SIC Code Searc	742
Number of Transactions	15

Similar to the IBA Database, I broke the set of comparable sales down even further into high, low, mean and median. I also broke down the top and bottom percentiles and quartiles (10% and 25%). It appears that the subject Company is closest to the "Top 10%" in revenue, "High" in discretionary earnings and "Top 10%" in discretionary earnings as a percentage of sales. Based on this analysis, I believe that the subject Company should be classified by the "Top 25%" for the price to revenue multiplier and "Top 25%" for the price to discretionary earnings multiplier.

Other Notes: The Company's results were also consistently highly ranked in the Bizcomps database and, once again were closest to either the High or Top 10% categories. Again, I felt my concern regarding the Company's declining sales should be reflected with a more conservative choice of multipliers and used the Top 25% for each calculation of value.

[18] Business Valuation Resources

5.3.1.4 Pratt's Stats Data

An initial search of the Pratt's Stats database produced 4 transactions for NAICS or SIC Code 742 with median revenues of $549,562.[19] The comparable transactions in detail have been kept in our work file. A summary of the data is presented below:

Table 5.3.1.4a
Market Approach - DMDM
Pratt's Stats Data - Summary

	Annual Sales	MVIC	MVIC / Sales	MVIC / SDE	MVIC / EBITDA	EBIT %
High	$1,279,000	$1,000,000	0.78	2.62	5.61	22%
Top 10%	$1,117,000	$873,400	0.78	2.62	5.60	19%
Top 25%	$874,000	$683,500	0.78	2.62	5.58	15%
Mean	$661,948	$443,250	0.55	2.62	4.88	12%
Median	$549,562	$339,000	0.58	2.62	5.55	10%
Low 25%	$337,510	$98,750	0.34	2.62	4.52	7%
Low 10%	$296,806	$96,500	0.29	2.62	3.89	6%
Low	$269,669	$95,000	0.26	2.62	3.48	6%
Coefficient of Variance			0.50	0.00	0.25	
Subject Company	$599,312					21%
Mean, Median or Other Selected Selected			Mean 0.55	Mean 2.62	Mean 4.88	

NAICS / SIC Code Searche	742
Number of Transactions	4

Similar to the IBA Database and Bizcomps Database, I broke the set of comparable sales down even further into high, low, mean and median. I also broke down the top and bottom percentiles and quartiles (10% and 25%). It appears that the subject Company is closest to the "Median" in revenue and "Median" in EBIT as a percentage of sales. Based on this analysis, I believe that the subject Company should be classified by the "Mean" for the price to revenue multiplier, "Mean" for the price to seller's discretionary earnings multiplier and "Mean" for the price to EBITDA multiplier.

Other Notes: The Pratt's Stats database contains only 4 comparable transactions and cannot be considered statistically relevant for our consideration of value. Nevertheless, I did use the Mean multipliers to calculate values that might provide some insight to our final conclusion of value.

[19] Business Valuation Resources

5.3.1.5 PeerComps Data

An initial search of the PeerComps database produced 185 transactions for NAICS code(s) 541940 with median revenues of $854,000.[20] The comparable transactions in detail have been kept in our workfile. A summary of the data is presented below:

Table 5.3.1.5a
Market Approach - DMDM
PeerComps Data - Summary

	Annual Sales	Annual SDE	SP / Sales	SP / SDE	SP / EBITDA	SDE %
High	$3,929,000	$1,210,000	1.38	4.13	7.80	59%
Top 10%	$1,881,200	$484,200	0.98	3.70	4.90	37%
Top 25%	$1,324,066	$339,250	0.88	3.28	4.35	32%
Mean	$1,059,817	$280,140	0.76	2.80	3.76	28%
Median	$854,000	$237,000	0.77	2.77	3.78	27%
Low 25%	$634,051	$178,800	0.64	2.36	3.21	23%
Low 10%	$515,990	$136,800	0.49	2.05	2.65	19%
Low	$203,060	$75,887	0.13	0.59	0.66	14%
Coefficient of Variance			0.26	0.24	0.27	
Subject Company	$599,312	$235,753				39%
Mean, Median or Other Selected Selected			Mean 0.76	Mean 2.80	Mean 3.76	

NAICS Code Searched	541940
Number of Transactions	185

Similar to the previous Databases, I broke the set of comparable sales down even further into high, low, mean and median. I also broke down the top and bottom percentiles and quartiles (10% and 25%). It appears that the subject Company is closest to the "Low 25%" in revenue, "Median" in SDE and "Top 10%" SDE as a percentage of sales. Based on this analysis, I believe that the subject Company should be classified by the "Mean" for the price to revenue multiplier, "Mean" for the price to seller's discretionary earnings multiplier and "Mean" for the price to EBITDA multiplier.

Other Notes: Comparing the Company's results to the quartiles arranged from the PeerComps database showed varied results from the Top 10% to the Low 25%. I used the Mean multipliers (given the low coefficients of variance) for all three calculations of value.

[20] PeerComps.com

5.3.1.6 IBA Market Data – Price to Sales

The following is a chart showing the calculation of an indicated value using the Price / Gross Sales Multiple for the DMDM using the data obtained from The Institute of Business Appraisers, Inc.:

Table 5.3.1.6a
Market Approach - DMDM
IBA Market Data - Price to Gross Sales

Next Year's Forecasted Sales		$620,288
Price / Gross Sales Multiple		0.82
Gross Value		$508,636
Adjustments:		
The information shown in the Market Comparison tables was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below:		
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Estimated Indicated Value - Price / Gross Sales Method		$508,636

The indicated value using the Price / Gross Sales Multiple for the DMDM using IBA data for XYZ Animal Hospital is $508,636. This represents a control level of value because all the transactions used in the above calculation were from the sale of 100% interest in the assets sold.

Other Notes: None.

5.3.1.7 IBA Market Data – Price to Earnings

The following is a chart showing the calculation of an indicated value using the Price / Earnings Multiple for the DMDM using the data obtained from The Institute of Business Appraisers, Inc.:

Table 5.3.1.7a
Market Approach - DMDM
IBA Market Data - Price to Earnings

Next Year's Forecasted EBIT		$131,865
In this method, the owner's compensation is typically added back to determine value.		$92,153
Adjusted EBIT Plus Owner/Manager Compensation		$224,018
Price / Earnings Multiple		3.58
Gross Value		$801,983
Adjustments:		
The information shown in the Market Comparison tables was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below:		
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Estimated Indicated Value - Price / Earnings Method		$801,983

The indicated value using the Price / Earnings Multiple for the DMDM using IBA data for XYZ Animal Hospital is $801,983. This represents a control level of value because all the transactions used in the above calculation were from the sale of 100% interest in the assets sold.

Other Notes: None.

5.3.1.8 Bizcomps Data – Price to Sales

The following is a chart showing the calculation of an indicated value using the Price / Gross Sales Multiple for the DMDM using the data obtained from Bizcomps:

Table 5.3.1.8a
Market Approach - DMDM
Bizcomps Data - Price to Gross Sales

Next Year's Forecasted Sales		$620,288
Price / Gross Sales Multiple		0.75
Gross Value		$465,216
Adjustments:		
The information shown in the Market Comparison tables was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below:		
Inventory Adjustment:		
The transactions included in the Bizcomps database do not include inventory. Therefore, inventory must be added to the gross value to arrive at a value including inventory.		
Add: Inventory	$0	
Gross Value Including Inventory		$465,216
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Estimated Indicated Value - Price / Gross Sales Method		$465,216

The indicated value using the Price / Gross Sales Multiple for the DMDM using Bizcomps data for XYZ Animal Hospital is $465,216. This represents a control level of value because all the transactions used in the above calculation were from the sale of 100% interest in the assets sold.

Other Notes: None.

5.3.1.9 Bizcomps Data – Price to Seller's Discretionary Earnings (SDE)

The following is a chart showing the calculation of an indicated value using the Price / SDE Multiple for the DMDM using the data obtained from Bizcomps:

Table 5.3.1.9a
Market Approach - DMDM
Bizcomps Data - Price to Seller's Discretionary Earnings

Next Year's Forecasted Seller's Discretionary Earnings (SDE)		$244,004
Price / Seller's Discretionary Earnings Multiple		3.48
Gross Value		$849,135
Adjustments:		
The information shown in the Market Comparison tables was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below:		
Inventory Adjustment:		
The transactions included in the Bizcomps database do not include inventory. Therefore, inventory must be added to the gross value to arrive at a value including inventory.		
Add: Inventory	$0	
Gross Value Including Inventory		$849,135
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Estimated Indicated Value - Price / Discretionary Earnings Method		$849,135

The indicated value using the Price / SDE Multiple for the DMDM using Bizcomps data for XYZ Animal Hospital is $849,135. This represents a control level of value because all the transactions used in the above calculation were from the sale of 100% interest in the assets sold.

Other Notes: None.

5.3.1.10 Pratt's Stats Data – Market Value Invested Capital (MVIC) to Sales

The following is a chart showing the calculation of an indicated value using the Price / Gross Sales Multiple for the DMDM using the data obtained from Pratt's Stats:

Table 5.3.1.10a
Market Approach - DMDM
Pratt's Stats - MVIC to Gross Sales

Next Year's Forecasted Sales		$620,288
Price / Gross Sales Multiple		0.55
Gross Value		$339,608
Adjustments:		
The information shown in the Market Comparison tables was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below:		
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Estimated Indicated Value - Price / Gross Sales Method		$339,608

The indicated value using the Price / Gross Sales Multiple for the DMDM using Pratt's Stats data for XYZ Animal Hospital is $339,608. This represents a control level of value because all the transactions used in the above calculation were from the sale of 100% interest in the assets sold.

Other Notes: None.

5.3.1.11 Pratt's Stats Data – MVIC to Seller's Discretionary Earnings (SDE)

The following is a chart showing the calculation of an indicated value using the Price / SDE Multiple for the DMDM using the data obtained from Pratt's Stats:

Table 5.3.1.11a
Market Approach - DMDM
Pratt's Stats - MVIC to Discretionary Earnings

Next Year's Forecasted Seller's Discretionary Earnings (SDE)		$244,004
Price / Seller's Discretionary Earnings Multiple		2.62
Gross Value		$639,291
Adjustments:		
The information shown in the Market Comparison tables was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below:		
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Estimated Indicated Value - Price / Discretionary Earnings Method		$639,291

The indicated value using the Price / SDE Multiple for the DMDM using Pratt's Stats data for XYZ Animal Hospital is $639,291. This represents a control level of value because all the transactions used in the above calculation were from the sale of 100% interest in the assets sold.

Other Notes: None.

5.3.1.12 Pratt's Stats Data – MVIC to EBITDA

The following is a chart showing the calculation of an indicated value using the Price / EBITDA Multiple for the DMDM using the data obtained from Pratt's Stats:

Table 5.3.1.12a
Market Approach - DMDM
Pratt's Stats - MVIC to EBITDA

Next Year's Forecasted EBITDA		$148,626
Price / EBITDA Multiple		4.88
Gross Value		$725,295
Adjustments:		
The information shown in the Market Comparison tables was obtained primarily from business brokers. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below:		
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Estimated Indicated Value - Price / EBITDA Method		$725,295

The indicated value using the Price / EBITDA Multiple for the DMDM using Pratt's Stats data for XYZ Animal Hospital is $725,295. This represents a control level of value because all the transactions used in the above calculation were from the sale of 100% interest in the assets sold.

Other Notes: None.

5.3.1.13 PeerComps Data – Price to Gross Sales

Table 5.3.1.13a
Market Approach - DMDM
PeerComps - Price to Gross Sales

Next Year's Forecasted Sales		$620,288
Price / Gross Sales Multiple		0.76
Gross Value		$471,553
Adjustments:		
The information shown in the Market Comparison tables was obtained primarily from SBA lenders. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below:		
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Estimated Indicated Value - Price / Gross Sales Method		$471,553

The indicated value using the Price / Gross Sales Multiple for the DMDM using PeerComps data for XYZ Animal Hospital is $471,553. This represents a control level of value because all the transactions used in the above calculation were from the sale of 100% interest in the assets sold.

Other Notes: None.

5.3.1.14 PeerComps – Price to Seller's Discretionary Earnings (SDE)

Table 5.3.1.14a
Market Approach - DMDM
PeerComps - Price to Seller's Discretionary Earnings (SDE)

Next Year's Forecasted Seller's Discretionary Earnings (SDE)		$244,004
Price / Seller's Discretionary Earnings Multiple		2.80
Gross Value		$683,186
Adjustments:		
The information shown in the Market Comparison tables was obtained primarily from SBA lenders. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below:		
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Estimated Indicated Value - Price / Discretionary Earnings Method		$683,186

The indicated value using the Price / Seller's Discretionary Earnings Multiple for the DMDM using PeerComps data for XYZ Animal Hospital is $683,186. This represents a control level of value because all the transactions used in the above calculation were from the sale of 100% interest in the assets sold.

Other Notes: None.

5.3.1.15 PeerComps Data – Price to EBITDA

Table 5.3.1.15a
Market Approach - DMDM
PeerComps - Price to EBITDA

Next Year's Forecasted EBITDA		$148,626
Price / EBITDA Multiple		3.76
Gross Value		$559,435
Adjustments:		
The information shown in the Market Comparison tables was obtained primarily from SBA lenders. The businesses are typically sold as asset only sales. Accordingly, the value generated using this method must be adjusted for the assets and liabilities that would not transfer in a normal sale as shown below:		
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Estimated Indicated Value - Price / EBITDA Method		$559,435

The indicated value using the Price / EBITDA Multiple for the DMDM using PeerComps data for XYZ Animal Hospital is $559,435. This represents a control level of value because all the transactions used in the above calculation were from the sale of 100% interest in the assets sold.

Other Notes: None.

5.3.1.16 Summary of DMDM and Indication of Value

The table below shows the calculation of the DMDM (Market Approach) value reflected by each of the applications shown above:

Table 5.3.1.16a
Market Approach - DMDM
DMDM Conclusion

Application	Value Selected	Selected Value	Coefficient of Variance	Confidence Level	Extension
IBA - Price / Sales	Top 25%	$508,636	0.33	0%	$0
IBA - Price / DE	Top 25%	$801,983	0.85	0%	$0
Bizcomps - Price / Sales	Top 25%	$465,216	0.38	0%	$0
Bizcomps - Price / SDE	Top 25%	$849,135	0.39	0%	$0
Pratt's Stats - MVIC / Sales	Mean	$339,608	0.50	0%	$0
Pratt's Stats - MVIC / SDE	Mean	$639,291	0.00	0%	$0
Pratt's Stats - MVIC / EBITDA	Mean	$725,295	0.25	0%	$0
PeerComps - MVIC / Sales	Mean	$471,553	0.26	50%	$235,776
PeerComps - MVIC / SDE	Mean	$683,186	0.24	25%	$170,796
PeerComps - MVIC / EBITDA	Mean	$559,435	0.27	25%	$139,859
Indicated Value - Private / Illiquid, Controlling Basis				100%	$546,432

Analysis of Range of Values: As shown above, the values ranged between $339,608 and $849,135. As indicated earlier, I classified the subject Company by sales and profitability into percentiles, quartiles and averages. Based on the analysis, I'm confident in the level selected for each fundamental. The IBA, Bizcomps, & PeerComps databases apply more to "mainstreet" or smaller businesses. Pratt's Stats is more geared towards larger "M&A" type transactions.

For the market approach, I have selected to rely solely on the PeerComps – Price / Sales, Price to SDE, and Price to EBITDA methods because of the low coefficient of variance and confidence in the number of transactions. I felt the "multiples" for the PeerComps database more closely reflected the risk and marketability of the subject Company. The PeerComps transaction information is gathered from SBA lenders and the transactions were financed with SBA loans. For our calculation of value I placed 50% of the weighting on the Price/Sales method and 25% each to the two methods based on SDE and EBITDA.

Control and Liquidity Characteristics of Value Indication: The values generated by the DMDM represent a control level of value because all the transaction used in the DMDM were from the sale of 100% interest in the assets sold. It has also been established that the value calculated by the DMDM method was based on prices at which other closely held (non-marketable) interests were sold. Therefore, the indicated value is on a private-illiquid, control basis.

Conclusion of DMDM: As shown above, I have estimated a value of the subject entity using the Direct Market Data Method (DMDM) to be $546,432, which is the estimated illiquid, controlling value of all operating assets and liabilities included in the sale.

5.3.2 Application of the Income Approach – Capitalization of Earnings (net cash flow)

The discounting of future benefits to a present value is a theoretically correct method of value when investors are seeing a return on their investment. This method is dependent upon two inputs, the projection of the future benefits and the determination of a suitable discount rate. The Single Period Capitalization Method (or Capitalization of Earnings Method) is used when the future benefit stream is expected to change in a constant and predictable way from year to date (i.e. grow at a constant rate).

5.3.2.1 Conceptual Basis

The Capitalization of Earnings Method looks not to the assets of the company, but instead to the income stream which could be paid to the owner. The value of the ownership interest is the amount an investor would be wiling to pay today for the right to receive a certain amount of money in the future in the form of periodic cash payments. Where the annual payments are expected to be even, a projection of annual cash flows is made and reduced to present value using a discount rate reflecting the riskiness of the company as an investment.

The development of the method requires the following decisions:

1. The selection of a type of financial return to be capitalized.
2. A decision as to whether to use that return applicable to equity or invested capital.
3. The selection of a capitalization rate to be applied to the return selected.

5.3.2.2 Return to be Capitalized

Discount and capitalization rates that are developed using publicly-held data, such as Ibbotson and Duff & Phelps should be applied to the net cash flow, sometimes called net free cash flow (dividend paying capacity) of a company.[21] In this case, I will be capitalizing both free cash flow, but also seller's discretionary earnings, also known as owner benefit.

5.3.2.3 Equity or Invested Capital

In this case, I will use net cash flow to invested capital – debt and equity. Net cash flow applicable to invested capital neither recognizes interest expense in the calculation of adjusted net income nor recognizes principal repayments and new borrowing when converting net income to net cash flow. Later, when the value of invested capital is determined, the amount of the debt to be assumed will be subtracted to arrive at the value of equity.

5.3.2.4 Net Cash Flow to Invested Capital

The calculation of next year's net cash flow to invested capital is shown on the following page. A description of the components used to convert net income to net cash flow follows the exhibit:

[21] Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweihs. Valuing a Business: The Analysis and Appraisal of Closely Held Companies. Fourth Edition. New York: McGraw-Hill, 2000, page 193.

Table 5.3.2.4a
Projected Net Cash Flow to Invested Capital

December:	Projected 2009	Tax Return 2008	Tax Return 2007	Tax Return 2006
Adjusted EBITDA	$57,706	$178,935	$235,916	$196,538
Weight	40%	30%	20%	10%
Weighted EBITDA	$143,600			
Less: Ongoing Depreciation	($16,195)			
Weighted EBIT	$127,406			
Growth Rate for Next Year	3.5%			
Next Year's EBIT	$131,865			
Corporate or Personal Taxes	($34,614)			
Debt Free Net Cash Flow	$97,250			
Add: Depreciation	$16,195			
Deduct: Cap Ex Reserve	($12,998)			
Deduct: Working Cap. Req.	($2,497)			
Next Year's Free Cash Flow	$97,950			

Forecasted EBIT: Weighting is reasonable when the appraiser concludes the return of any one or more years is a more reliable indicator of future returns than are the returns of the other years. As shown in Section 3.7, I analyzed the historical revenue and expenses, borrower projections and industry forecasts to arrive at a reasonable EBIT projection based on weighting historical years. I have projected EBIT to be $131,865 for the first year of the projection.

Tax Adjustment: Taxes have been adjusted to "S Corporation" tax structure. A "C Corporation" would be adjusted to standard rates (as if publicly held) of 40%. However, it can be assumed that most "asset" acquisitions of C corporations will be changed to S corporation status. S Corporations are adjusted to 26.25%, which would be the "adjusted rate" based on the Delaware Open MRI Radiology Associates vs Kessler case in 2006. In this case, the courts essentially arrived at a method to account for the benefits of being a shareholder in an S Corporation over a publicly held C Corporation. To calculate the benefit, the Vice Chancellor compared the cash that would be received by a C Corporation shareholder to that which would be received by an S Corporation shareholder. This calculation allowed the court to determine an effective tax rate to use in lieu of a 40% tax rate, which mimicked the effect of the avoided dividend tax. A tax adjustment for an "S" corporation simply replaces an "S Corporation Premium".

Capital Expenditures & Depreciation: These two adjustments are interrelated. Capital expenditures are an estimate of the amount the company will need to spend in a representative year (not necessarily any specific year) to acquire additional plant and equipment. Depreciation is an estimate of a representative year. The influencing factors include: (1) An estimate of future capital expenditures (assets which will be subject to depreciation); (2) historical depreciation; and (3) the relationship which should exist between capital expenditures and depreciation (capital expenditures should be an appropriate amount greater than depreciation). This relationship is based on two assumptions: (a) In an inflationary economy, the cost of replacement items acquired will be greater than the cost of the item being replaced; and (b) in a growing business, the aggregate investment in depreciable assets will increase as the business grows.

Based on my analysis, I have estimated a long-term sustainable growth rate of 3.5%. Based on our discussions with the parties involved, it is assumed that the subject Company's fixed assets are adequate for its current size. Therefore, I've concluded that capital expenditures for the future would only need to be sufficient to maintain the current relationship of capital assets to sales with consideration of the need to replace capital assets which have either passed their physical life or have changed state of the art.

We know that the long term, due to the impact of inflation on the cost of replacement items plus the cost of new items, that more dollars will need to be spent in a typical year for capital assets than will be recovered through the depreciation of a typical year. For the proxy for capital expenditures, following discussions with the buyer and client, we assumed a 10 – Year average remaining life in the current capital assets and calculated the investment needed to replace them as follows: $96,282 in current capital assets divided by 10 years is $9,628. For additions to the capital asset base, I concluded that because the current capital asset base is adequate, it will need to grow at the rate of sales growth. That calculation is $96,282 at the 3.5% growth rate is $3,370. These two estimates combine to indicate the typical year investment in capital assets in present value dollars.

For depreciation, I used the same "weighted" figures on historical years as a percentage of sales. At the rate of growth in capital expenditures, it is reasonable to assume this current and historical relationship will continue close enough to provide a reasonable proxy for this component.

Working Capital Requirements: Changes in working capital are estimated based on the need to maintain the same level of working capital as a percentage of sales for previous years. The table below shows net working capital (working capital less cash minus debt free current liabilities) as a percentage of sales for historical periods and as of the valuation date. I have forecasted working capital requirements to be equal to 11.9% of annual growth throughout the projection period.

Table 5.3.2.4b
Working Capital Analysis

December:	Tax Return 2006	Tax Return 2007	Tax Return 2008	Historical Average
Total Sales	$710,955	$721,160	$629,603	$687,239
Net Working Capital				
(+) A/R in Days	0	0	0	0
(+) Inventory in Days	0	0	0	0
(-) A/P in Days	0	0	0	0
Days of Cash Needed	0	0	0	0
Days of Cash as $ Amount				
COGS	$161,325	$142,624	$174,672	$159,540
Cash Operating Expenses	$609,268	$596,383	$299,451	$501,701
Appraiser Adjustments	($250,680)	($249,111)	($23,189)	($174,327)
Adjusted Total Expenses	$519,913	$489,896	$450,934	$486,914
Total Daily Expenses	$1,424	$1,342	$1,235	$1,334
Normalized Worker Capital	$0	$0	$0	$0
Normalized WC as % of Sales	0.00%	0.00%	0.00%	0.00%

The working capital requirement is calculated by taking the difference in projected sales of $620,288 and weighted sales of $599,312 multiplied by the selected net working capital to sales ratio of 11.9%.

5.3.2.5 Development of a Suitable Discount Rate and Capitalization Rate

In order to apply the Capitalization of Earnings Method, an appropriate capitalization rate must be determined. A capitalization rate is any divisor that is used to convert a stream of earnings into an indication of value. A capitalization rate is usually derived from a discount rate. The rate of return used to capitalize (or discount) projected future income to a value today must be a reasonable proxy for the return necessary in the marketplace to attract the capital of the "willing buyer" inherent in the fair market value standard. Discount & capitalization rates reflect the risk associated with achieving the expected income from an investment. The higher the perceived risk of achieving the forecast stream, the higher the discount rate.

There is a significant amount of debate involving the subject of selecting an appropriate discount rate. However, most appraisers do agree that to estimate the discount or capitalization rate properly, it must reflect the size, liquidity, risk and character of the investment in the subject firm. In simplest terms, "… the capitalization or discount rate should be the expected rate of return available on alternative investment opportunities with comparable risk".[22]

There are several methods of determining the discount or capitalization rate. The most commonly used methods include:

Build-Up Method: The build-up method is typically used for both small and larger businesses. The premise of the build-up method is that the marketplace return is equal to the return on a risk free investment plus theoretically derived risk premium. The risk premium is indicative of the incremental rate of return demanded by investors in investments similar in risk to the subject.

Capital Asset Pricing Model: The capital asset pricing model is commonly used to the appraisal of medium-sized to larger private companies and its only real difference from the build-up approach is that a component is included to modify the rate based on industry risk. This industry risk adjustment is typically derived from the beta of guideline companies used. This method is not very applicable to small and very small companies.[23]

Weighted Average Cost of Capital or WACC: The weighted average cost of capital is another method applicable to medium-sized and larger businesses. It is based on determining the required rate of return on both equity and debt in a company. It is typically used when appraising the market value of invested capital and has components of the build-up approach.

Factor Rating: The factor rating method is a hybrid build-up approach that is popular with business brokers and small business owners. A number of risk factors are rated and weighted, then added together to determine a "multiple of cash flow", which can be inverted into a capitalization rate. There are many subjective steps and is only used with very small companies.

Selection: When an invested capital return is used, it is proper procedure to use a rate applicable to invested capital. In this case, I have selected the Weighted Average Cost of Capital or WACC.

[22] Shannon Pratt, Valuing a Small Business: The Analysis and Appraisal of Closely Held Companies; Homewood, IL: Down Jones-Irwin 1982
[23] Gary Trugman, Understanding Business Valuation: A Practice Guide to Valuing Small to Medium-Sized Businesses; New York: American Institute of Certified Public Accountants, 1998

The weighted average cost of capital is computed by applying an industry average debt to equity capital structure to the Company's cost of equity capital (i.e. the equity discount rate) and cost of debt capital. The equity discount rate for the Company was determined using the build-up approach. The build-up approach is based on the principle that a company's discount rate is composed of a number of identifiable risk factors that, when added together, result in a total return that a prudent investor would demand from the purchase of a company. The summation of these rates of return components is illustrated below and each component is explained in the sections that follow the table:

Table 5.3.2.5a
After-Tax Equity Cost of Capital

Risk-free Rate of Return (20-year treasury)	4.5%
Equity Risk Premium for Smaller Stocks	12.5%
Company Specific Risk Premium	7.0%
Total Cost of Equity	24.0%

Risk Free Rate: Although there probably is no such thing as a risk free investment, the financial community for many years has adopted by convection the use of rates of return demanded by investors in government securities as a surrogate for a risk free investment. The risk free rate of return most commonly used by business valuators in the United States is the US Treasury 20-year Bond Rate. The 20-year bond rate is used because it is thought to represent the best investment horizon for a privately-held business. At the date of valuation the rate of return required by investors in government securities was approximately 4.5%.[24]

Equity Risk Premium for Smaller Stocks: The equity risk premium is the extra return demanded by investors in stocks over that demanded by lenders. A commonly used source for estimating the equity risk premium for smaller stocks is the Duff & Phelps Risk Premium Report, a company that publishes an annual study based on publicly held stock returns over the yields on U.S. Treasury rates.[25] At the date of valuation the most recent such data indicated that on average investors in the smallest publicly traded stocks demanded (and got) a rate of return about greater than the yield on 20-year U.S. Treasury obligations.[26] In selecting this measure of the equity risk premium, I'm persuaded by fact that this is a demonstrated return to shareholders of the smallest publicly held companies, over a long period of observation and takes into consideration both the equity risk and size risk. The following chart shows the risk premium for the smallest publicly held stocks:

[24] US Treasury Yield as of 01/15/10. http://www.ustreas.gov/offices/domestic-finance/debt-management/interest-rate/yield_historical.shtml
[25] Duff & Phelps, LLC, Risk Premium Report 2007.
[26] Duff & Phelps, LLC, Risk Premium Report 2008. Exhibit A-1 to A-8.

Table 5.3.2.5b
Duff & Phelps, LLC - Risk Premium Report - 2009
Equity Risk Premiums over Risk-Free Rate: Guideline Portfolios

	Company Size	Relevant Exhibit	Guideline Portfolio	Premium Over Risk-Free Rate
Market Value of Equity	$99mm	A-1	25	13.6%
Book Value of Equity	$60mm	A-2	25	12.1%
5-Year Average Net Inc.	$3mm	A-3	25	13.0%
MVIC	$135mm	A-4	25	13.1%
Total Assets	$120mm	A-5	25	12.4%
5-Year Average EBITDA	$12mm	A-6	25	12.7%
Sales	$108mm	A-7	25	12.0%
Number of Employees	256	A-8	25	12.4%
Mean premium over risk-free rate				12.7%
Median premium over risk-free rate				12.5%

Company-Specific Risk Premiums: The company-specific risk premium is a component of the total rate of return that an investor would demand because of the generally greater risk of investing in the subject Company over and above the risk of investing in the stock of small publicly-traded companies. Accordingly, this component of the rate of return is unique to the subject Company and takes into consideration the additional size risk smaller companies have compared to publicly held companies. There is no readily available source of information that can effectively be used to determine the unsystematic risk, identified as the company-specific risk premium. This risk premium is ultimately based on the analytical skill, judgment and experience of the appraiser and is subjective. In estimating what I believe is an appropriate company-specific increment to the rate of return earned by investors in small publicly-traded stocks, I considered several aspects of the subject Company, which were discussed earlier and throughout the report.

The following is a summary of the components of the specific-risk premium based on the factors discussed:

Table 5.3.2.5c
Discount Rate & Capitalization Rate
Specific Risk Premium

Company Specific Risk Premium - to Small Publicly Held Companies

1. Industry Risk	0%	Industry performanc and projections show growth
2. Financial Risk	2%	Company has shown significantly slowing sales
3. Depth of Management	1%	Single professional practice relies on owner/veterinarian
4. Level of Diversification	1%	Limited services and limited geographic coverage
5. Competition Risk	1%	Declining sales may indicate increased competition
6. Access to Capital	1%	Smaler companies have less access to capital
7. Risk in Achieving Projections	1%	Declining sales trend increases risk
Company Specific Risk Premium	7%	

* comparison to a small public company

Rand Curtiss[27] indicates that for practical reasons the company specific premium ranges from -5% for a very low risk business to 20% for a very high risk business. The sum of the risk free rate, the equity risk premium, and the size premium is typically around 16%. Therefore a range of -5% to 20% for the company specific premium corresponds to discount rates from 11% to 35%. The value of 35% corresponds to the low end of venture capital rates of return for later-stage investments. For most well established privately-held companies, the company specific risk premium will usually range from 3% to 10%.

After adding up the risk free rate, equity risk premium for small publicly-held stocks and company-specific risk premium, the build-up approach indicates an equity discount rate of 24.0%.

The next step is to calculate the Company's cost of debt capital. In this case, the Company's cost of debt capital (after-tax) was estimated to be 4.6% by using a pretax debt cost of 3.3% (estimated prime rate), adding a premium of 3% to account for the fact that a bank would require a personal guarantee, and applying an effective tax rate of 26.25% (as discussed under table 5.3.2.4a).

The weighted average cost of capital is derived through application of an industry average debt to equity capital structure to the equity discount rate and debt cost of capital. I've utilized the Duff & Phelps debt to MVIC median average for the smallest public companies, which was 24.5%. The final adjustment required to convert the weighted average discount rate to a weighted average cost of capital is to account for expected growth. The discount rate is the cost of capital or rate of return used to convert a monetary sum into present value. The capitalization rate is a divisor that is used to convert income into value. The difference between the two is the annually compounded rate of growth in the economic variable that is being capitalized over the life of the investment. The critical assumption underlying this simple adjustment is that the economic income variable is expected to have a constant average annual compounded rate of growth into perpetuity. I have utilized a long-term expected growth rate of 3.5% to account for expected short-term growth, general inflation, industry growth and Company long-term growth.

The computation of the weighted average cost of capital is illustrated below:

Table 5.3.2.5d
Weighted Average Cost of Capital (WACC)

	Cost of Capital	Industry Ave. Capital Structure	WACC
After-Tax Equity Cost of Capital	24.0%	75.5%	18.1%
After-Tax Debt Cost of Capital	4.6%	24.5%	1.1%
Subtotal			19.2%
Less: Long-Term Growth Rate			-3.5%
Weighted Average Cost of Capital			15.7%

[27] Rand M. Curtiss, MCBA, FIBA, ASA "Quantifying the Specific Company Equity Risk Premium" Business Appraisal Practice, Fall 2003, published by The Institute of Business Appraisers.

5.3.2.6 Summary and Indication of Value

Calculation of Initial Value: As shown below, I divided next year's forecasted net cash flow to invested capital of $97,950 by the capitalization rate of 15.7% to arrive at the value of invested capital of $622,834. To arrive at the equity value, I deduct any interest bearing debt. Because the underlying basis for the discount rate from which I derived the capitalization rate are rates of return paid for highly liquid securities, the value indication from this method is considered to be "as-if-freely-traded" or marketable. As discussed below, I have also made certain adjustments to reflect the assets and liabilities included in the proposed sale. The calculation of the Capitalization of Free Cash Flow Method is shown below:

Table 5.3.2.6a
Income Approach
Capitalization of Free Cash Flow

Next Year's Forecasted Net Cash Flow to Invested Capital		$97,950
Capitalization Rate		15.7%
Value of Invested Capital (marketable, controlling basis)		$622,834
Less: Interest Bearing Debt		$0
Equity Value (marketable, controlling basis)		$622,834
Adjustments for Assets / Liabilities Not Included in Sale:		
The equity value generated from this method includes all operating assets and liabilities. The value must be adjusted for any operating assets or liabilities not included in the sale.		
Add: Total Liabilities Not Included in the Sale	$58	
Deduct: Normal Cash Not Included in the Sale	($102,939)	
Deduct: A/R Not Included in the Sale	$0	
Deduct: Other Assets Not Included in the Sale	$0	
Total Assets / Liabilities Not Included in the Sale		($102,881)
Indicated Value - Public / As If Freely Traded, Controlling Basis		$519,953

Adjustments for Assets & Liabilities, Not Included in Sale: The typical buyer of a small business will most likely acquire the "assets" of a business rather than the "stock" or "equity of the business. Most assets sales include only fixed assets, goodwill and inventory. The equity value generated from this method includes all operating assets and liabilities. The value must be adjusted for any operating assets and liabilities not included in the sale.

Single-Period Capitalization Method Conclusion: After making certain adjustments shown above, I have calculated a value of the subject entity using the Single-Period Capitalization Method of $519,953, which is the estimated marketable (as if freely traded), controlling value of all operating assets and liabilities included in the sale. This value is prior to application of any discounts or premiums.

5.3.3 Application of the Income Approach – Capitalization of Seller's Discretionary Earnings

Although unconventional, I have also decided to capitalize the Company's seller's discretionary earnings (SDE), also known as "owner benefit". Since most buyers of smaller businesses are more focused on a "return on owner's labor" (as compared to the traditional net cash flow to equity methods which are based on return on equity or capital), I believe the capitalization of owner's benefit should be considered.

5.3.3.1 Development on a Suitable Capitalization Rate (or multiple)

To capitalize seller's discretionary earnings, I have also chosen to calculate the factor rating method for valuing the subject interest. As mentioned above, the "factor rating" method is primarily used for valuing small businesses (also known as the Business Brokerage Segment[28]) with the following common attributes:

- Revenues up to $5 million;
- Pertinent measure of earnings is Seller's Discretionary Earnings or Adjusted Cash Flow;
- Active owner-operator working full time;
- Predominantly "asset sales" rather than "stock sales";
- Return on owner's labor paradigm (rather than return on equity/investment).

Several methods exist for determining a proper multiple or cap rate, all of which are based on a series of factor evaluations pertaining to important risk-related elements associated with the firm the industry and the economy. These methods, all of which are geared towards pretax measures of discretionary earnings such as SDE Included:

1. Jones Method (multiples, 1 to 3)
2. Schilt's Risk Premia (cap rate: 5 risk premia plus risk-free rate)
3. Black and Green (cap rate: 6 primary risk categories)
4. ValueNetex (cap rate: 8 major risk categories)

Each method has it pros and cons, varying in terms of the following criteria:

- Number of risk factors
- Applicable scale for evaluating risk factors
- Resulting output may be a multiple or a capitalization rate (inverse of each other)
- Weighting of specific risk factors
- Direct or indirect treatment of "economic conditions"
- Frequency of usage for specific types and sizes of privately-held firms.

As mentioned, each of the seven methods listed earlier has it pros and cons, but I have decided to use a factor rating method that takes into consideration both the price to earnings multiples for small businesses and specific risk factors normally used in a traditional "Build Up" approach. My analysis and estimation of the capitalization rate is shown below:

[28] The Business Valuation Book: Published by the American Management Association and Amacom Publishing.

Table 5.3.3.1a
Discount Rate & Capitalization Rate
Calculated for Seller's Discretionary Earnings

IBA Database - Price to SDE Average	3.1
Bizcomps Database - Price to SDE Average	2.4
Pratt Stats Database - Price to SDE Average	2.5
Average of 3 Databases	2.7
Related Cap Rate (1/multiple)	37.6%
Add/(Deduct): Specific Company Risk	3.0%
Adjusted Cap Rate on Seller's Discretionary Earnings	40.6%
Calculated Multiple (inverse of cap rate)	**2.5** x

Average Price to SDE Multipliers: My first step was to research the total number of transactions from the 3 databases discussed in Section 5.3.1.1. Based on my analysis, the average price to Seller's Discretionary Earnings multiplier for the entire IBA Database was approximately 3.1. The average price to SDE multiplier for the entire Bizcomps Database was approximately 2.4. The average price to SDE multiplier for the entire Pratt's Stats database was approximately 2.5. It should be noted that the IBA database shows a slightly higher multiple most likely because they do not include depreciation as an adjustment to cash flow. It should also be noted that although multiples in Bizcomps are presented "exclusive of inventory" (inventory value must be added to the value generate via the multiple and discretionary earnings), the impact of inventory on most businesses will be relatively small (in comparison to the overall business value). It could be assumed that a sample size of nearly 40,000 comparable sales should be a reasonable for a "basis" for the "average" multiple of SDE. The average price to SDE for the 3 databases is approximately 2.7.

Develop Capitalization Rate: My second step was to convert the multiple into a capitalization rate. Since the capitalization rate is the inverse of the multiple, I've used the following simple formula – 1 / multiple = capitalization rate. The capitalization rate before a specific company risk adjustment is approximately 37.6%.

Company-Specific Risk Premiums: The 3rd and final step is to adjust the capitalization rate for risk factors specific to the subject Company. I've taken the same approach as I would with a traditional "Ibbotson's Build Up Approach". The company-specific risk premium is a component of the total rate of return that an investor would demand because of the generally greater (or lesser) risk of investing in the subject Company over and above the risk of investing in similar privately-held companies. Accordingly, this component of the rate of return is unique to the subject Company. There is no readily available source of information that can effectively be used to determine the unsystematic risk, identified as the company-specific risk premium. This risk premium is ultimately based on the analytical skill, judgment and experience of the appraiser and is subjective. In estimating what I believe is an appropriate company-specific increment to the rate of return earned by investors in small privately-held businesses, I considered several aspects of the subject Company, which were discussed previously and throughout the report:

On the following page is a summary of the components of the specific-risk premium based on the factors mentioned above:

Table 5.3.3.1b
Discount Rate & Capitalization Rate
Specific Risk Premium

Company Specific Risk Premium - to Privately Held Companies		
1. Financial Performance/Stability/Projection Risk	2.0%	Declining trend in sales creates some added risk
2. Size & Years of Operation	0.0%	Company has been active more than 30 years
3. Location & Market	-1.0%	Large metropolitan market should support services
4. Dependence on Owner or Key Employees	2.0%	Single owner practice for 3 decades, some dependence
5. Customer & Supplier Diversification	-1.0%	No customer or vendor concentration
6. Competition / Barriers to Entry	1.0%	Company's declining sales may indicate incrased competition
7. Overall Marketability / Pool of Buyers	-1.0%	Should attract numerous individual buyers
8. Industry & Impact on Business	-1.0%	Industry conditions and projections are positive
9. National / Regional Economy & Impact on Bus.	2.0%	Declining sales may be related to high unemployment locally
10. Market Diversity (Prod./Service & Geography)	0.0%	Limited services and limited geographic coverage is normal
Company Specific Risk Premium	3.0%	

Key	
High Risk	2%
Moderately High Risk	1.5%
Above Average Risk	1%
Average Risk	0%
Below Average Risk	-1%
Moderately Low Risk	-1.5%
Low Risk	-2%

As shown above, I've classified the Company Specific Risk into 10 categories: 2% = High Risk; 1.5% = Moderately High Risk; 1% = Above Average Risk; 0% = Average Risk; -1% = Below Average Risk; -1.5% = Moderately Low Risk; -2% = Low Risk. These percentage factors were chosen due to the range of SDE multipliers for the 3 databases. For instance, if we used all "low risk" factors of -2%, the SDE multiplier would be approximately 6x. This multiplier would be close to the top 10 percentile (highest 10%) for all SDE multipliers for the 3 databases. Similarly, if we used all "high risk" factors of 2%, the SDE multiplier would be approximately 1.7x or close to the bottom 10 percentile (lowest 10%). Therefore, the model appears consistent and reliable.

After adding the Company Specific Risk Premium to the unadjusted capitalization rate, I have calculated an adjusted capitalization rate on Seller's Discretionary Earnings (SDE) to be approximately 40.6%. This would result in a multiplier of SDE or owner's benefit of 2.5x.

5.3.3.2 Development of an Income Stream

Capitalization rates that are developed using the above method should be applied to the Seller's Discretionary Earnings, also called Adjusted Cash Flow or Owner Benefit. I'm using SDE as my earnings base because as discussed earlier, small businesses in the "business brokerage segment" typically are "bought and sold" by their level of SDE or "owner benefit". The buyer typically is more concerned with the level of benefits (salary, profit, personal expenses paid by the company) than net cash flow return on investment.

As discussed in Section 4.6a, weighting historical performance is a common way to project future performance. Based on the weighting discussed earlier, I've calculated projected Seller's Discretionary Earnings to be $244,004. Please see Section 4.4.2 and Table 4.4.2a for details.

5.3.3.3 Summary and Indication of Value

Calculation of Initial Value: As shown below, I have calculated an initial value by capitalizing next year's forecasted seller's discretionary earnings. Because the underlying basis for the discount rate from which I derived the capitalization rate are rates of return paid for other privately held businesses, the value indication from this method is considered to be "privately held" or illiquid. The calculation of the Capitalization of Seller's Discretionary Earnings method is shown below:

Table 5.3.3.3a
Income Approach
Capitalization of Seller's Discretionary Earnings

Next Year's Forecasted Seller's Discretionary Earnings		$244,004
Capitalization Rate		40.6%
Gross Value - Before Adjustments		$601,085
Adjustments:		
The typical buyer of a small business will most likely acquire the "assets" of a business rather than the "stock" or equity of the business. The majority of assets sales include only fixed assets, inventory and goodwill. Therefore, the value should be adjusted for the assets and liabilities that would or would not transfer in a normal sale as shown below:		
Add: Assets Typically Not Included in a Sale:		
Cash & Equivalent	$0	
Accounts Receivable	$0	
Other Current Assets	$0	
Total Assets Typically Not Included in a Sale		$0
Less: Liabilities Typically Not Included in a Sale:		
All Liabilities	$0	
Total Liabilities Typically Not Included in a Sale		$0
Indicated Value - Private / Illiquid, Controlling Basis		$601,085

Adjustments for Assets & Liabilities, Not Included in Sale: The typical buyer of a small business will most likely acquire the "assets" of a business rather than the "stock" or equity of the business. Most assets sales include only fixed assets, goodwill and inventory. The initial value generated from this method includes only fixed assets, inventory and goodwill. The value must be adjusted for any operating assets and liabilities included or not included in the sale.

Capitalization of Seller's Discretionary Earnings – Conclusion: After making certain adjustments shown above, I have calculated a value of the subject entity using the Capitalization of Discretionary Earnings Method of $601,085, which is the estimated privately-held (illiquid), controlling value of all operating assets and liabilities included in the sale. This value is prior to application of any discounts or premiums.

6.0 Adjustments to Indicated Values

Before applying the final weighting and reconciliation of the indicated values to determine the final estimate of value, the need for any adjustments for non-operating assets, discounts and premiums must be reviewed.

6.1 Non-Operating Assets

As of the valuation date, there were no non-operating assets included in the sale.

6.2 Discounts and Premiums

Shannon Pratt states, discounts and premiums are the result of using less-than-perfect data to measure value.[29] A discount, or premium, is applied to a base value to bring the subject interest to a common level. The two general levels of difference that are commonly observed include control (or lack thereof) and marketability (or liquidity).

6.2.1 Discounts & Premiums Related to Control

Identification of a control interest or a minority (non-controlling) interest in a business is very important. Control refers to the ability to manage or control the business. A minority interest, by definition, does not have control. Minority interests in a business are typically worth less, often a lot less, than the proportionate share of the business.[30]

Control Premium: If the initial value calculated is on a non-controlling basis (such as when using data from public companies) and the appraiser is trying to value a controlling interest, sometimes a control premium is required. A variety of studies has been conducted to examine control premiums paid. *Mergerstat Review*, a common source of control premium data, calculates the premium based on the buyout prices over the market price of the seller's stock five business days prior to the announcement date. However, it is difficult to know exactly how much of the premium was related to gaining control or synergistic value – many analysts argue that a large portion of the control premiums include synergy. As shown in previous sections, my initial indications of value were on a controlling basis either because the values were based on sales of 100% interests or because adjustments were made to the income statement that only a controlling shareholder could make. Therefore, a control premium is not required.

Discount for Lack of Control: If the initial value calculated is on a controlling basis (such as when using data from comparable sales of private companies) and the appraiser is trying to value a non-controlling interest, sometimes a discount for lack of control (also known as minority interest discount) is required. Unfortunately, there is not a method currently available for directly observing discounts for lack of control in the marketplace. Instead, discounts for lack of control are calculated using control premiums. As shown in previous sections, my initial indications of value were on a controlling basis. Since I'm valuing a controlling interest, a discount for lack of control is not required.

[29] Shannon P. Pratt. Business Valuation Discounts and Premiums. New York: John Wiley & Sons, Inc. 2001, page xxi
[30] Jay E. Fishman, Shannon P. Pratt, J. Clifford Griffith, and D. Keith Wilson. Guide to Business Valuations. Fort Worth: Practitioners Publishing Business, 1999. Ninth Edition, Volume 2, p. 8-15

6.2.2 Discounts Related to Marketability

The lack of marketability is not related to the desirability of the subject Company, but to the lack of liquidity in the marketplace. The discount for lack of marketability (hereafter referred to as "DLOM") recognizes the fact that the shares of closely held businesses are not as liquid as the shares of publicly traded companies due to the lack of a ready market. Unlike a stockholder of a publicly traded company, a stockholder of a closely held business cannot immediately sell or liquidate the ownership interest in the closely held business. It is generally accepted within the appraisal profession that the standard for marketability (or liquidity) is "cash in three days". It usually takes time (usually much longer than 3 days), money and a considerable amount of effort to sell an ownership interest in a closely held business.

6.2.2.1 Marketability Discounts – Controlling vs. Non-Controlling Values

Marketability discounts are usually and regularly applied to non-controlling, marketable values when trying to calculate a non-controlling, non-marketable value. However, according to David Bishop in his article "Lack of Marketability Discounts for Controlling Interest", a DLOM "is appropriate for controlling interests when the fair market value of an operating company is indicated by a valuation method under the income approach developed on an "as if freely traded" basis."[31] Bishop also discusses Chris Mercer's position on marketability discounts for controlling interests covered in chapter eleven of his book, *Quantifying Marketability Discounts*. Bishop summarizes Mercer's position stating that the discount for a controlling interest would clearly be different than for a minority interest. The two discounts, a minority marketability discount and a control marketability discount (usually called an illiquidity discount) would be taken from different valuation basis. He further states that the various studies relevant to minority marketability discounts do not apply to the issue of a control marketability discount.

6.2.2.2 Selection of the DLOM (or Lack of Liquidity)

Capitalization of Free Cash Flow: For valuing the 100% controlling interest in the subject Company, a marketability discount must be identified that will be sufficient to covert the controlling marketable value to a controlling non-marketable value. As discussed earlier, DLOMs for controlling interest are calculated different compared to DLOMs for non-controlling interest. It has already been established that the initial indicated values are on a controlling basis. It has also been established that the value calculated by the DMDM method was based on prices at which other closely held (non-marketable) interests were sold, so the value indicated was on a private-illiquid, control basis. Therefore, the discount in question is a DLOM for a controlling interest (known as an illiquidity discount) to be applied to the Income Approach. Unfortunately, there is little direct evidence available to determine the size if this discount. The marketplace, however, does tell us that most frequently controlling interests in closely held companies sell for less than do controlling interests in publicly traded companies. Market studies performed by FactSet Mergerstat[32] and published in the Mergerstat Review indicate the prices paid to acquire controlling interests in privately owned companies imply discounts which over the last 10 years average a 16% discount from the prices paid to acquire controlling interests in publicly traded companies.

It could be assumed that one of the primary reasons for the difference in prices paid would be that the private companies lacked marketability. If other variables are ignored, the difference could be seen as a basis for concluding the marketability difference applicable to controlling interests in closely held

[31] Bishop, David M. "Lack of Marketability Discounts for Controlling Interests," *Business Appraisal Practice*, published by the Institute of Business Appraisers, Inc., Spring 2000, p. 39.
[32] Mergerstat Review, FactSet Mergerstat. Table I-12 Page 20.

companies is 16%. However, as indicated above, there are other variables which influence the average price to earnings differences such as size, management depth, diversification, quality of financial information, etc. These considerations force us to conclude that while lower prices paid for closely held companies were undoubtedly influenced by their lack of marketability, they were also influenced by other factors.

The table below presents the differences in the average price to earnings ratios paid for controlling interests in publicly traded companies and controlling interests in closely held companies:

Exhibit 6.2.2.2a
Median Price/Earnings Ratios
Controlling Interest Acquisitions
Publicly Traded Compared to Closely-Held

	Publicly Traded		Closely-Held		
Year	P/E Ratio	# of Transactions	P/E Ratio	# of Transactions	Implied Discount For Closely-Held Companies
1998	24.0	362	16.0	207	33%
1999	21.7	434	18.4	174	15%
2000	18.0	379	16.0	130	11%
2001	16.7	261	15.3	80	8%
2002	19.7	161	16.6	83	16%
2003	21.2	198	19.4	107	8%
2004	22.6	188	19.0	108	16%
2005	24.4	230	16.9	127	31%
2006	23.7	294	21.4	65	10%
2007	24.9	300	21.6	64	13%
Arithmetic Average of Annual Implied Discounts					16%
Source: Mergerstat Review 2008					

Another consideration is the cost to take the company public or to prepare for and execute a sale. If the stockholder decides to sell the ownership interest, the stockholder would incur certain expenses in connection with the transaction, including legal and accounting fees and possibly transaction or brokerage fees. Legal and accounting fees for small businesses generally range from 1% to 3% of the transaction price depending on the size of the transaction. Brokerage fees for small businesses will generally range from 6% to 12%. Total fees typically range from 7% to 15%.

The above considerations lead us to conclude the range of discounts reasonable for the valuation of most controlling interests should be between 7% and 20%. As a final step, I looked at specific factors that could be expected to influence the discount further. Those factors are presented on the following page:

Factors That May Increase the Discounts for Lack of Marketability:

1. Restrictions on transfer.
2. Little or no dividends or partnership payout.
3. Little or no prospect of either a public offering or sale of company.
4. Thin market for the size of block being appraised.
5. Seller unwilling to sign a covenant not to compete.

Factors That May Decrease the Discount for Lack of Marketability

6. Market exists for the interest being valued.
7. History of meaningful dividends or partnership payout.
8. Imminent public offering or sale of the company.
9. Interest being valued is sufficient to cause liquidation, sale or merger.
10. No restriction on the sale of the interest being valued.
11. A "put" option (with a reasonable prospect of being enforced and funded).

Factors That May Increase or Decrease Discount for Lack of Marketability

12. A buy/sell agreement.
13. Size of the block being valued.
14. The distribution of the remaining shares.
15. The size of the company.
16. The stability of its earnings.

Factors 6, 7, 9 and 10 argue for a smaller discount for reasons explained earlier in the report. There does not appear to be any factors to argue for a larger discount. Based on the above analysis, I believe that a smaller discount of is appropriate – let's say 10%

Capitalization of Seller's Discretionary Earnings: It has also been established that the value calculated by the Capitalization of Discretionary Earnings method was based on prices at which other closely held (non-marketable) interests were sold, so the value indicated was on a private-illiquid, control basis. Therefore, no discount for lack of liquidity or marketability is warranted as the values are already on a control, privately-held basis.

7.0 Weighting and Reconciliation of Indicated Values

I have outlined each of the methods discussed in Section 4 and discounts applicable to these methods as discussed in Section 5. Uniform Standards of Professional Appraisal Practice (USPAP) clearly indicates that an appraiser cannot simply take a mathematical average or make some other set calculation to arrive at a final value. Instead, "The appraiser must evaluate the relative reliability of the various indications of value. The value conclusion is the result of the appraiser's judgment."[33]

The various indications of value are shown below:

Table 7.0a
Summary of Valuation Methods

Valuation Method	Value and Basis Indicated By Method	Adjustments for Differences in Degree of: Marketability	Control	Adjusted Value and Basis	Confidence Level	Incremental Value
Cost Approach						
Adjusted Book Value	$96,282 Illiquid, Control	0%	0%	$96,282 Illiquid, Control	0%	$0
Market Approach						
Direct Market Data Method (DMDM)	$546,432 Illiquid, Control	0%	0%	$546,432 Illiquid, Control	50%	$273,216
Income Approach						
Capitalization of Net Cash Flow	$519,953 Liquid, Control	10%	0%	$467,958 Illiquid, Control	25%	$116,989
Capitalization of Discretionary Earnings	$601,085 Illiquid, Control	0%	0%	$601,085 Illiquid, Control	25%	$150,271
Value Conclusion						
Fair Market Value: 100% Interest - Private / Illiquid, Control Basis - Excluding Nonoperating As					100%	$540,476
Fair Market Value: Excess Working Capital						$0
Fair Market Value: Other Nonoperating Assets						$0
Fair Market Value: 100% Interest - Private / Illiquid, Control Basis - Including Nonoperating Assets						$540,476
Interest Appraised						100%
Value Conclusion						$540,476
Value Conclusion (rounded)						$540,000

Reconciliation is shown on the following page:

[33] Uniform Standards of Professional Appraisal Practice, The Appraisal Foundation, Washington DC, 2000 Edition, Standards Rules 9-5, p. 65.

Reconciliation – Asset Approach: Although I have calculated the adjusted book value method, I have decided not to weight this method. In spite of the fact that the Company has some investment in tangible assets, I believe that an investor would evaluate XYZ Animal Hospital based primarily upon the aggregate earnings and cash flow generating capability of the Company's combined assets, rather than on the basis of individual asset values.

Reconciliation – Market Approach: The Direct Market Data Method (DMDM) utilized in this report uses actual sales of privately-held companies to determine value. The direct applicability of the data to the subject company is never known; however, by using a larger number of transactions, a reasonable indication of value can be inferred. In this case, we were able to find a sufficient amount of comparable transactions that were similar in size and within the same industry. I have a relatively high confidence in the comparable transactions and therefore have given the overall market approach 50% weight.

Reconciliation – Income Approach: I have utilized two Single Period Capitalization Methods, including the capitalization of free cash flow and capitalization of seller's discretionary earnings. Since projected earnings are expected to be relatively stable, I have elected to capitalize a sustainable earnings base. The majority of potential business buyers give significant credence to the actual and expected return on free cash flow. However, a "multiplier of owner cash flow" approach was also derived in reflection of "real world" valuation and negotiation tactics used by typical buyers and sellers of small businesses. The majority of potential business buyers of this nature give significant credence to the actual and expected owner cash flow. Therefore, I believe that both income approaches should also be weighted equally at 25% for the remaining 50% of the total.

7.1 Value Conclusion

Based upon the facts presented in the accompanying report, it is my conclusion that the fair market value of the 100% controlling, illiquid interest in XYZ Animal Hospital, as of September 30, 2009, is best expressed as:

$540,000

Analysis of Purchase Price: The buyer and seller have agreed upon a purchase price of $500,000 for a 100% Asset Interest in the subject business. As shown above, our value of $540,000 is above the purchase price.

8.0 Review of Final Estimate of Value for Reasonableness

The following section is supplied to give additional support to the value conclusion stated for the 100% interest in the common stock of XYZ Animal Hospital. Although not considered an "appraisal method", there are various rules of thumb that exist that are common applied to the subject industry. I will also discuss the reasonableness of the value by using a Purchase Justification Test, which outlines a typical transaction and ability to service debt.

8.1 Rules of Thumb

According to Tom West, editor of the Business Reference Guide, the following rules of thumb exist for "Veterinary Practices and Clinics - pages 710 - 715":[34]

Rules of Thumb

	Rule of Thumb - Low	Rule of Thumb - High	Plus Equipment	Plus Inventory	ROT Value - Low	ROT Value - High
Price to Revenue	70%	80%	$0	$0	$434,201	$496,230
Price to SDE	2.00	2.00	$0	$0	$488,009	$488,009
Price to EBITDA	NA	NA	$0	$0	NA	NA
Price to EB IT	NA	NA	$0	$0	NA	NA

If applied to the forecasted revenue and earnings of the subject Company, the rules of thumb shown above calculate enterprise values between $434,201 and $496,230. The enterprise values normally calculated based on the Business Reference Guide include fixed assets, inventory and goodwill. The final value I have calculated including only fixed assets, inventory and goodwill is $540,476, which falls above the rule of thumb values.

8.2 Purchase Justification Test

To test the reasonableness of my opinion of the Company's fair market value, I've performed a purchase justification test based on a hypothetical sale. This analysis includes assumptions regarding the cash down payment the terms of the purchase notes, and the business's projected cash flows. These assumptions are presented below:

Source of Purchase Funds	Percentage	Amount	Terms In Months	Interest	Monthly Payment
Required Cash From Buyer	20%	$108,095			
3rd Party Financing	80%	$432,381	120	8.25%	$5,303
Seller Take Back Note	0%	$0	0	0.00%	NA
Total	100%	$540,476			$5,303

Value is based on "Enterprise" or Asset Value, which is the standard for a small business.

[34] Business Reference Guide, 2010, Written & Edited by Tom West

Based on the above assumptions, I have created a projected cash flow taking into consideration a hypothetical sale. Under a typical business acquisition loan from the Small Business Administration (typical for this size business), the business is financed for 10 years at prime plus 2%. The forecast, return on down payment is shown below:

Table 8.2a
Post Sale Cash Flow

	Projected Year 1
Projected EBIT	$131,865
3rd Party Note Interest	($34,589)
Seller Note Interest	NA
Projected Post Sale EBT	$97,275
Income Taxes @ 26%	($25,535)
Projected Net Income	$71,741
Depreciation/Amortization	$16,195
Less: Capital Expenditures	($12,998)
Less: Working Cap Inc.	($2,497)
3rd Party Principle Pmt.	($29,050)
Seller Note Principle Pmt.	NA
Cashflow to Shareholder	$43,390
Return on Down Payment	40%

As shown above, based on a hypothetical sale, the hypothetical buyer is able to service the associate debt and still receive a fair rate of return on the cash down payment of 40% in the first year. Based on the rule of thumb and above analysis, it appears the final value is reasonable.

9.0 Professional Qualifications of Appraiser

Appraiser Background

Steve Mize, ASA. Mr. Mize is the managing partner of the GCF Valuation and is responsible for Business Valuations and matters of litigation support. Mr. Mize is an experienced business valuation professional with over 10 years of experience specializing in this field and has an excellent record in the development an implementation of valuation and financial strategies. Mr. Mize has been directly involved in numerous business valuation engagements for estate and gift tax purposes, dissenting shareholder actions, Employee Stock Ownership Plans, as well as consulting engagements related to fairness opinions, private transactions, and value improvement.

The GCF Valuation is a nationally respected firm specializing in providing valuation and consulting services for intermediaries and their respective clients as well as selected IPO candidates.

Education

The Florida State University, Bachelor of Science, Business Administration, specializing in Financial Strategies; Entrepreneurship Small Business Management (ESBM).

Mr. Mize was recognized as successfully completing the ESBM program at the Florida State University. The board of directors only accepts 40 participants of 2,000 + applicants. The program specializes in financial strategies for closely held businesses and is one of the most well recognized programs offered. The program is known for its rigorous case studies and only a 39% pass rating.

Professional Affiliations and Designations

- American Society of Appraisers – successfully has passed all 4 business valuation classes (BV201, BV202, BV203, & BV204) as well as the ethics exam and USPAP exam. Other classes include various courses offered at the annual conferences.

- Accredited Senior Appraiser with the American Society of Appraisers (in Business Valuation). Final accreditation on May 13, 2004.

- Member of the Institute of Business Appraisers (IBA) – successfully completed Course 1010 – Report Writing, Review and Analysis and Course 1046 – Weighted Average Cost of Capital.

- Various on-line presentations offered by Business Valuation Resources.

- National Association of Guaranteed Government Lenders – provides training to commercial lenders on business valuation and financial analysis.