BANKABILITY METHOD™

In the context of business valuation through the Income Approach, Innovative Business Advisors has pioneered a novel technique known as the Bankability Method™. This proprietary methodology serves to ascertain the level of debt service that a company can prudently manage based on its present revenue and earnings trajectory, without compromising the operational integrity of the enterprise.

Bankability Method™

What is the Bankability Method?

This proprietary method serves to ascertain the level of debt service that a company can prudently manage based on its present revenue and earnings trajectory, without compromising the operational integrity of the enterprise.

Who uses this method?

This method is widely used by lending institutions for Small Business Administration (SBA) lending, which is the primary source of capital for U.S. Small Business.

Why is this method useful?

This method is useful because the SBA estimates that traditional bank lending is the most common form of credit for businesses generating less than $10 million in annual revenue. Business entities in the United States are classified into four distinct size categories:

1. **Large enterprises** – greater than 1,000 employees; greater than $1 billion annual revenues
2. **Medium enterprises** – between 100 – 999 employees; greater than $10 million annual revenues
3. **Small enterprises** – less than 100 employees; less than $10 million annual revenues
4. **Very small enterprises** – less than 10 employees; less than $1 million annual revenues

Very small and small business enterprises are estimated to comprise slightly more than 30 million business entities in the U.S. For businesses within these categories, the SBA estimates that traditional bank-style lending comprises the most common form of credit available and used by entities of these size categories.

What amount will a bank lend to a business buyer?

Since traditional bank lending is the most common form of credit for businesses generating less than $10 million in annual revenue, it’s relevant to use a valuation method that answers the questions -

“What is a bank willing to lend a credit worthy borrower who wants to purchase an existing business of this type?”

AND

“How will the bank come to that lending dollar amount conclusion?”

So, to help answer these common questions, Innovative Business Advisors came up with the Bankability Method™ to figure out how much debt the business can handle based on its earnings history. We use a special number called the "debt service coverage ratio" to show the bank that there's enough money to pay back the loan. We also work out how much money you need to put in (a down-payment or equity injection in bank speak) and what interest rate is current for today's market.

All of these steps lead us to a quantifiable number we refer to as the "bankable value." This number represents the amount of money that a bank could potentially lend to someone who has a demonstrated capacity for prudent financial management. We refer to this specific value as the "Bankability Method™ – Estimated Selling Price" in this valuation report.

What is the bankable value of FECC?

Refer to the next page for the calculation of FECC's Bankability MethodTM– Estimated Selling Price.

BANKABILITY METHODTM
ESTIMATED SELLING PRICE

How is the Estimated Selling Price calculated?

The estimated selling price is calculated by aiming for a specific debt service coverage ratio, such as 1.50. This means that the business produces free cash flow of $1.50 for every $1.00 dollar of debt payment. First, we calculate the money available to cover debt payments (EBITDA) by subtracting a reasonable salary for the owner/manager from the average earnings the business produced in the past. This yields an amount we call "money available to cover debt payment." Then, we calculate how much money needs to be paid each month to cover the proposed loan for buying the business. This monthly payment depends on factors like the loan type, how much money is put down for the business(the equity injection), the interest rate (which is prime rate, plus an SBA premium), and the loan term. After that, we subtract the loan payment from the "money available to cover debt", and what's left is the extra profit monies after making the annual loan payment. This information is used to calculate the targeted coverage ratio.

Below are the steps taken to value William David based on the multi-stage growth method.

Company Valuation (Bankability)

$4,425,000

(1) Calculation of FECC's Cash Flow Available for Debt Service (EBITDA)

(A) Seller's Discretionary Earnings - Selected Ongoing SDE Base		$ 1,046,702	
(B) Reasonable Owner / Manager Salary - (existing)	250,000		
(C) Reasonable Owner / Manager Salary - (existing)		250,000	= B
(D) Equals: Cashflow available for Debt Service (CADS)		$ 796,702	= A - C

(2) Lending Details - FECC Purchase (assumptions)

(E) Loan Type:	SBA 7a		
(F) Down Payment as a % of Purchase Price	10%		
(G) Down Payment Amount	$442,500		
(H) Loan Amount:	$3,982,500		
(I) Prime Rate:	8.00%		
(J) SBA Interest Premium:	2.25%		
(K) Market Loan Interest Rate (I + J)	10.25%		
(L) Loan Period (years)	10		
(M) Annual Debt Service Payment (principal + interest per terms above):		638,183	
(N) Excess Cash Flow After Debt Service		$ 158,519	= D - M

(3) Resulting Capitalization Rate

(O) EBITDA / Purchase Price	18.0%
(P) Debt Service Coverage Ratio (D / M)	1.25

(4) Bankability Method TM - Estimated Selling Price **$ 4,425,000**

Estimated Selling Price - Low (based on 1.75 coverage ratio)	$3,150,000
Estimated Selling Price - High (based on 1.25 coverage ratio)	$4,425,000