Business Valuation Report

Prepared for:

Peter Panini

Subject Company

Sample Hardware C.C.
Cape Town

30 November 2011
Re: Appraisal of Sample Hardware C.C.

Dear Peter,

We have been engaged to estimate the fair market value of the business known as Sample Hardware C.C., as of 30 November 2011 for the purpose of offering the business for sale. At your request, we have provided a restricted use limited appraisal report, which is advisory in nature and intended to be used as a guideline for offering the business for sale.

For the purposes of business appraisal, *Market value* is the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

This appraisal assumes a fully marketable, controlling ownership interest in the assets of the business. The appraisal was performed under the premise of value in continued use as a going concern. In our opinion this premise of value represents the highest and best use of the business assets.

Based on the information contained in the report that follows, it is our estimate that the fair market value of Sample Hardware C.C. is:

**Business Enterprise Value:**  R 1 246 376

The Business Value includes inventory, furniture, fixtures and equipment, and all intangible assets, including business goodwill. It excludes cash, or cash equivalents, accounts receivable, real estate, non-operating assets and all business liabilities. The valuation is subject to the information provided to us as well as the assumptions and financial data which appear in the report.

We have appraised the subject business in accordance with the *International Valuation Standards* (IVS) published by the International Valuation Standards Council.

Kind Regards

Andrew Hubbard
Financial Statement Reconstruction and Forecasts

Accurate estimation of business value depends upon the business financial performance. While historical financials are important, business value relies upon the ability of the business to continue producing desired economic benefits for its owners.

Many closely held companies are managed to minimize taxable income. To determine the business value accurately, the company’s historic financial statements, such as its Income Statements and Balance Sheets, generally require certain adjustments.

The objective of these adjustments is to reconstruct the historic financial statements in order to reveal the true economic potential and earning power of the business. The result of these adjustments is referred to as Adjusted Net Profit throughout this report.

Earnings Basis used for Business Valuation:
Small and Medium business valuations generally rely upon some measure of business cash flows as the earnings basis. The most commonly used earnings basis measures include:

- Seller's discretionary cash flow (SDCF).
- Net Cash flow

Seller's Discretionary Cash Flow
A widely accepted definition of SDCF is:

1. Pre-tax business net profit.
2. Plus total compensation of a single owner-operator.
3. Plus adjustment of all other working owners' compensation to market rate (manager replacement).
4. Plus annual depreciation and amortization expense.
5. Plus interest expense.
6. Plus non-recurring expenses.
7. Plus expenses not related to the business operations.

We make reference to Adjusted net Income in this report, which is the same as the Sellers discretionary Cash flow.

Sources of Company Financial Information and Historic financial statements have not been obtained from the business management and have not been audited to confirm their accuracy. In preparing this report we have taken these financial statements and projections to be true and accurate. Furthermore the projections in this report are for illustration purposes only, the growth assumptions have been provided by the business owner and have been adopted without any critical evaluation.
Reconstructed Income Statements and 5 year forecast

The summary of the recent 12 months performance of the company including the appropriate adjustments, and a 5 year Forecast are summarised in the table below. Aldes Atlantic takes no responsibility for the accuracy of these numbers:

The following assumptions were provided by the business owner:

Revenue growth year by year 6.0% Ave. monthly turnover 250 000
Gross Profit Margin 56.0% Ave. monthly Profits 50 000
Escalation of Operating Expenses 8.0%

<table>
<thead>
<tr>
<th>Income Items / Expense</th>
<th>Last 12 months</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross revenues</td>
<td></td>
<td>3 000 000</td>
<td>3 180 000</td>
<td>3 370 800</td>
<td>3 573 048</td>
<td>3 787 431</td>
</tr>
<tr>
<td>Cost of Goods Sold (COGS)</td>
<td></td>
<td>1 320 000</td>
<td>1 399 200</td>
<td>1 483 152</td>
<td>1 572 141</td>
<td>1 666 470</td>
</tr>
<tr>
<td>Gross Profit</td>
<td></td>
<td>1 680 000</td>
<td>1 780 800</td>
<td>1 887 648</td>
<td>2 000 907</td>
<td>2 120 961</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>(1 080 000)</td>
<td>(1 166 400)</td>
<td>(1 259 712)</td>
<td>(1 360 489)</td>
<td>(1 469 328)</td>
<td>(1 586 874)</td>
</tr>
<tr>
<td>Adjusted net Profit</td>
<td>600 000</td>
<td>614 400</td>
<td>627 936</td>
<td>640 418</td>
<td>651 633</td>
<td>661 345</td>
</tr>
</tbody>
</table>

Business Valuation Approaches and Methods

There are three fundamental ways to measure the value of a business or professional practice:

- Asset approach
- Market approach.
- Income approach.

Under each approach, a number of methods are available which can be used to determine the value of a business enterprise. Each business valuation method uses a specific procedure to calculate the business value.

As a matter of principle all the valuation methods make use of comparative data. The Asset based methods use the comparative business transactions to determine the earnings multipier used in this industry. The market based methods use various multipliers from comparative businesses to establish the business value. The earnings based methods use the data to determine the average capitalisation Rate used for similar businesses.

No one business valuation approach or method is definitive. Hence, it is common practice to use a number of business valuation methods under each approach. The business value then is determined by reconciling the results obtained from the selected methods. Typically, a weight is assigned to the result of each business valuation method. Finally, the sum of the weighted results is used to determine the value of the business.

This process of concluding the business value is referred to as the business value synthesis.
Asset Approach
The asset approach to business valuation considers the underlying business assets in order to estimate the value of the overall business enterprise. This approach relies upon the economic principle of substitution and seeks to estimate the costs of re-creating a business of equal economic utility, i.e. a business that can produce the same returns for its owners as the subject business. The business valuation methods under the Asset Approach include:

- Asset accumulation method.
- Capitalized excess earnings method. (also referred to as Extra Earning Potential - EEP)

Market Approach
Under the Market Approach to business valuation, one consults the market place for indications of business value. Most commonly, sales of similar businesses are studied to collect comparative evidence that can be used to estimate the value of the subject business. This approach uses the economic principle of competition which seeks to estimate the value of a business in comparison to similar businesses whose value has been recently established by the market.

The business valuation methods under the Market Approach are:

- Comparative private company transaction method.
- Comparative publicly traded company transaction method.

Income Approach
The Income Approach to business valuation uses the economic principle of expectation to determine the value of a business. To do so, one estimates the future returns the business owners can expect to receive from the subject business. These returns are then matched against the risk associated with receiving them fully and on time.

The returns are estimated as either a single value or a stream of income expected to be received by the business owners in the future. The risk is then quantified by means of the so-called capitalization or discount rates. The methods which rely upon a single measure of business earnings are referred to as direct capitalization methods. Those methods that utilize a stream of income are known as the discounting methods. The discounting methods account for the time value of money directly and determine the value of the business enterprise as the present value of the projected income stream.

The methods under the Income Approach include:

- Discounted cash flow method.
- Multiple of Adjusted Net Profits method.
- Capitalisation of earnings method
Asset-Based Business Valuation Result

To estimate the value of the subject business under the Asset Approach, this report uses the Extra Earning Potential method. The method works to determine the business value as the sum of the following:

1. The fair market value of the tangible assets of the business.
2. Business goodwill.

For the purposes of this report, the tangible assets of the business has been reported by the owner of the business, and has not in any way been verified by Aldes Atlantic Business Brokers.

Business goodwill is calculated by capitalizing the value of business “extra earnings”. Extra earnings Potential is the difference between the Adjusted Cash Flow of the business and a fair return on the net tangible assets. We have used the South African Risk free return Rate of 6.0% to calculate the fair return on the business assets valued at R 400 000.

Furthermore, this method deducts the expense of a manager from the Adjusted Net Profits of the business for the purpose of calculating the extra earnings. Based on the size of the business, we have used an average for this industry of R 84 000 p.a. (Note: the business value may vary if this value needs to be adjusted substantially).

After deduction of Interest on the Assets of R 24 000 and the cost of the manager of R 84 000 (Total deduction from the Adjusted Net Profits of the subject business = R 108 000, the Extra Earnings Potential (EEP) of the business comes to R 492 000 p.a.

To calculate the value of the goodwill in the business, the monthly EEP of R 41 000 is now multiplied with the industry average multiplier for the Hardware Industry. This multiplier of 22 months is the average payback period in months that was achieved on average by 64 businesses either sold or marketed during the last 4 years in the same industry using the same methodology.

Using this method the total value of the Extra Earnings comes to R 886 204. This is also the value of the Goodwill of the company.

The value of the business, using the Extra Earnings Method is calculated as follows:

- Value of Net Tangible Assets: R 400 000
- Value of Business Goodwill: R 886 204

Business Value: R 1 286 204

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Market-Based Business Valuation Results

The market-based business valuation relies upon the comparison of the subject business to similar business transactions entered into within the last 4 years.

The companies selected for comparison are closely held firms which resemble the subject business in terms of their financial and operational characteristics.

We utilize the Comparative Transaction Method to estimate the value of the subject business. Under this method, one determines the so-called valuation multiples which relate some measure of business financial performance to its potential selling price. Typical valuation multiples are:

- Price divided by the gross revenues.
- Price divided by the Gross Profit of the business
- Price divided by (Gross Revenue minus Fixed Overheads) - referred to as operational profits
- Price divided by Adjusted net Profit
- Price divided by fair market value of the business asset base

Each valuation multiple is a ratio statistically derived from the selling prices and financials of the private companies either sold or marketed in the same industry as the subject business.

We calculate each valuation multiple as a weighted average of the lowest (minimum), median, average and highest (maximum).

In the table below, the following basis values are calculated based on information provided by the seller:

- Gross revenue, Gross profits, operational profit, Adjusted net profits, net tangible asset value.

<table>
<thead>
<tr>
<th>Type of Value Estimate</th>
<th>Basis</th>
<th>Weighted Multiple</th>
<th>Estimated Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price based on Gross Revenue</td>
<td>R 3 000 000</td>
<td>0.2891</td>
<td>R 867 216</td>
</tr>
<tr>
<td>Price based on Gross Profits</td>
<td>R 1 680 000</td>
<td>0.8729</td>
<td>R 1 466 392</td>
</tr>
<tr>
<td>Price based on operational profits</td>
<td>R 1 920 000</td>
<td>0.3509</td>
<td>R 673 777</td>
</tr>
<tr>
<td>Price based on Adjusted net Profit</td>
<td>R 600 000</td>
<td>1.8793</td>
<td>R 1 127 600</td>
</tr>
<tr>
<td>Price based on total assets</td>
<td>R 400 000</td>
<td>2.6667</td>
<td>R 1 066 663</td>
</tr>
<tr>
<td><strong>Average:</strong></td>
<td></td>
<td></td>
<td><strong>R 1 040 330</strong></td>
</tr>
</tbody>
</table>

To arrive at an estimate of the business selling price, as can be seen in the above table, we use each weighted valuation multiple and multiply it by the corresponding value of the subject business earnings or assets. The business value is now determined as the average of these selling price estimates.

**Business Value:** R 1 040 330

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Income-Based Business Valuation Results

Discounted Cash Flow method

This income-based business valuation method provides a highly accurate estimate of business value based on the business earning potential. Under this method, we determine the business value by discounting the future business earnings using the so-called discount rate which captures the business risk.

The use of this method requires the following three inputs:

1. Business net cash flow forecast over a pre-determined future period
2. Discount rate
3. Long-term residual business value

Our Income Statement forecast provides the net cash flow numbers five years into the future. Since the subject business is assumed to be debt-free, we use the discount rate derived from transactions of a similar nature entered into within the past 4 years.

Finally, the residual business value which represents that portion of business value past the net cash flow projection period is calculated using the present value of the perpetual cash flow.

The table below summarises the discount rate calculation:

<table>
<thead>
<tr>
<th>Discount Rate Element</th>
<th>Risk Value</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk-free rate of return</td>
<td>6.00%</td>
<td>rate of fixed interest bonds</td>
</tr>
<tr>
<td>Premium for equity investment</td>
<td>7.20%</td>
<td>risk premium for investing in public company stock, 75 year average</td>
</tr>
<tr>
<td>Premium for small/medium company size</td>
<td>10.00%</td>
<td>Risk premium for investing in a small to medium sized company</td>
</tr>
<tr>
<td>Industry specific risk premium</td>
<td>18.84%</td>
<td>Risk premium payable for the Industry Hardware</td>
</tr>
<tr>
<td>Equity Discount Rate</td>
<td>42.04%</td>
<td>Sum of the risk-free return plus the risk premia above</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>year 1</th>
<th>year 2</th>
<th>year 3</th>
<th>year 4</th>
<th>year 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 year cash flow forecast</td>
<td>R 614 400</td>
<td>R 627 936</td>
<td>R 640 418</td>
<td>R 651 633</td>
<td>R 661 345</td>
</tr>
</tbody>
</table>

The net present value (NPV) of the 5 year income stream of R 1 241 773 is now added to the NPV of the residual business value after the 5'th year (R 336 459). Under these assumptions, we arrive at the following estimate of business value:

Business Value: **R 1 578 232**
Income-Based Business Valuation Results

Price Earnings Ration (PE)
This method is sometimes also referred to as the magic multiplier or the multiple of price earnings (PE) method. For this method we have established an average for comparable transactions registered in the last 4 years. The multiplier of 21.6 months is used to multiply the monthly Adjusted net profit of R 50 000 to establish the estimated value of the business according to this method.

**Business Value:**  R 1 080 737

**Note:**

The Answers to the following questions usually have a material effect on the multiplier:

<table>
<thead>
<tr>
<th>General</th>
<th>Assets</th>
<th>Working Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>How long has the business been established ?</td>
<td>When on average do you need to replace your assets</td>
<td>What is the total amount needed as security:</td>
</tr>
<tr>
<td>How long does the current owner own the business ?</td>
<td>How much is the actual replacement value of your assets (without properties)</td>
<td>&gt; Rent deposit</td>
</tr>
<tr>
<td>Are all records, financials, VAT returns,... up to date ?</td>
<td></td>
<td>&gt; Suppliers</td>
</tr>
<tr>
<td>Is the business easily relocatable ?</td>
<td></td>
<td>&gt; other securities, deposits or guarantees</td>
</tr>
<tr>
<td>What is the duration of the lease incl. options ?</td>
<td></td>
<td>What is the average collection period for debtors</td>
</tr>
<tr>
<td>Are the lease terms (opening hours, lease/sqm,...) onerous ?</td>
<td></td>
<td>What are the average payment terms with creditors</td>
</tr>
<tr>
<td>Is the business a franchise ?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income</th>
<th>Suppliers</th>
<th>Products, Market &amp; Competition</th>
</tr>
</thead>
<tbody>
<tr>
<td>How much of your income is recurring income</td>
<td>Are your 3 biggest suppliers easily replacable</td>
<td>How high is the barrier to entry through Licenses, BEE or capital requirements</td>
</tr>
<tr>
<td>What is the sustainable revenue increase p.a.</td>
<td>If &quot;No&quot;: How much of your purchases are you byuing from your biggest 3 suppliers</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Clients</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>How many clients do you have</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Staff</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent is the business dependent on the current owner</td>
<td></td>
<td></td>
</tr>
<tr>
<td>What is the required skill level of your top employees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is the business easy to run without extensive knowledge of the industry</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

By way of illustration, if the majority of the above questions were to be answered negatively, the industry average multiplier of 21.6 would be reduced to 15.1, resulting in a business value of R 756 516. By the same token, if the majority of the questions were answered favourably, the multiplier could be increased to as much as 28.1, resulting in a business value of R 1 404 958. This variance in value between the two values for the business illustrates just how important the assessment of the broker is when using this method. Contact Aldes Atlantic Business Brokers if you would like the your business to be assessed more accurately using these factors.
# Conclusion of Business Value

We relied upon four methods under the Asset, Market and Income Approaches to business valuation: Capitalized Excess Earnings method (Also Extra Earnings Potential), Comparative Transaction method, Discounted Cash Flow and Price Earnings method.

We use the results obtained from these business valuation methods to provide an estimate of the subject business value. In our opinion, each of the business valuation methods utilized in this Report is equally relevant. Hence, we assign an equal weight to each result and calculate our estimate of the business value as the sum of these weighted values:

<table>
<thead>
<tr>
<th>Business Valuation Method</th>
<th>Approach</th>
<th>Value</th>
<th>Weight</th>
<th>Weighted Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extra Earning Potential (EEP)</td>
<td>Asset</td>
<td>R 1 286 204</td>
<td>25%</td>
<td>R 321 551</td>
</tr>
<tr>
<td>Comparative Transactions</td>
<td>Market</td>
<td>R 1 040 330</td>
<td>25%</td>
<td>R 260 082</td>
</tr>
<tr>
<td>Discounted Cash Flow</td>
<td>Income</td>
<td>R 1 578 232</td>
<td>25%</td>
<td>R 394 558</td>
</tr>
<tr>
<td>PE Ratio</td>
<td>Income</td>
<td>R 1 080 737</td>
<td>25%</td>
<td>R 270 184</td>
</tr>
<tr>
<td><strong>Indicated Business Value</strong></td>
<td></td>
<td><strong>R 1 246 376</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## Indicated Business Value

R 1 246 376
Statement of Limiting Conditions

This business appraisal relies upon the following contingent and limiting conditions:

1. We assume no responsibility for the legal matters including, but not limited to, legal or title concerns. Title to all subject business assets is assumed good and marketable.

2. The business interest and subject business assets have been appraised free and clear of any liens or encumbrances unless stated otherwise. No hidden or apparent conditions regarding the subject business assets or their ownership are assumed to exist.

3. All information provided by the client and others is thought to be accurate. However, we offer no assurance as to its accuracy.

4. Unless stated otherwise in this report, we have assumed compliance with the applicable laws and regulations.

5. Absent a statement to the contrary, we have assumed that no hazardous conditions or materials exist which could affect the subject business or its assets. However, we are not qualified to establish the absence of such conditions or materials, nor do we assume the responsibility for discovering the same.

6. Per agreement with the client, this appraisal report is limited scope. Not all pertinent information has been considered nor was a comprehensive valuation undertaken. This may affect the value conclusions presented in this report.

7. This report seeks to comply with the Report requirement of the International Valuation Standards (IVS) for limited scope Valuations as published by the International Valuation Standards Council. As a result, the report may not fully disclose all the information sources, discussions and business valuation methodologies used to

8. The valuation analysis and conclusion of value presented in the report are for the purpose of this engagement only and are not to be used for any other reason, any other context or by any other person except the client to whom the report is addressed.

9. The opinion of value expressed in this report does not obligate us to render a comprehensive business appraisal report, to give testimony, or attend court proceedings with regard to the subject business assets, properties or business interests, unless such arrangements have been made previously.

10. Possession of this report does not imply a permission to publish the same or any part thereof. No part of this report is to be communicated to the public by means of advertising, news releases, sales and promotions or any other media without a prior written consent and approval by us.

11. This report is valid only for the date specified herein.