



ALP LTD. VALUATION SERVICES PRESENTS:

Small Business Valuations Demystified: How We Determine the Value & Goodwill

 (506) 804-4430

 CMEA@ALPAtlantic.com

 www.BusinessAndAssetValues.com



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Advantage Liquidity Partners (ALP) Ltd. Valuation Services Presents:

Small Business Valuations Demystified:

How We Determine the Value & Goodwill

Executive Summary

This report from ALP Ltd. Valuation Services distinguishes between two essential types of business valuation: the Most Probable Selling Price (MPSP) report and Certified Machinery and Equipment Appraisals (CMEA). While the MPSP report assesses the value of a business as an ongoing entity, incorporating both tangible and intangible factors like brand and customer loyalty, the CMEA focuses strictly on the value of physical assets, independent of the business's operational context. Understanding the difference between these valuations is crucial for establishing fair market value, informed by both tangible asset value and goodwill.

Goodwill, the value arising from intangible elements that enhance a business's worth beyond its physical assets, is especially important in business transactions. This report underscores the role of goodwill in pricing, financing, and strategic decisions, offering a comprehensive perspective essential for buyers, sellers, and lenders to make well-rounded financial decisions.

Why You Should Read This Report

This report offers an invaluable guide for anyone involved in business acquisitions, sales, or financing decisions. By providing a complete view of business value—from tangible assets to goodwill—it equips stakeholders with the insights needed to set accurate pricing, assess financing opportunities, and support strategic growth. Whether you're looking to buy, sell, or finance a business, this report explains why understanding both types of valuation ensures informed, balanced, and strategic decisions that reflect the true worth of a business.

President's Message

Hi there and Welcome!

My name is David Barnett, and I founded Advantage Liquidity Partners Ltd. in 2008 and introduced Certified Machinery & Equipment appraisals in 2009.



Thanks for taking the time to download this report.

Our goal is to help you get your deal done and if you work with entrepreneurs, we want to help make you a better advisor to them.

If you received this report as a gift from someone, please take a moment to add yourself to our email list so that you can receive our monthly newsletter with short updates and educational clips about the world of appraisal and trends in capital equipment values.

Sign up at www.CMEAEmails.com or scan this QR code to open the signup form on your phone.



Over the years, I've had the pleasure of working with hundreds of entrepreneurs and their advisors and their brokers and have helped them get deals done.

I hope this report helps to shed light on the differences between the value of a business, the assets it owns and how we calculate the value of goodwill.

Thank you

A handwritten signature in blue ink, appearing to read 'David Barnett', is positioned above the printed name.

David C Barnett

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Business Value vs. Tangible Asset Value and Goodwill

At ALP Ltd. Valuation Services, we specialize in providing two types of critical valuations: the **Most Probable Selling Price (MPSP) report**, which determines the business's value as a going concern, and **certified machinery and equipment appraisals (CMEA)**, which focus on assessing tangible assets. While these approaches might seem similar, they each reveal unique aspects of a business's worth. Understanding the distinctions between these valuations—and the goodwill they uncover—is essential for owners, buyers, and financial stakeholders alike.

1. Business Valuation as a Going Concern: The MPSP Report

When we value a business as a going concern, we look at the full scope of the enterprise as an operational entity. This method encompasses not just the tangible assets but also the intangible aspects that contribute to its market value. Our MPSP reports analyze the financials, business model, industry benchmarks, and qualitative factors like brand reputation and customer loyalty to arrive at the **Most Probable Selling Price** under normal transaction terms.

The value derived from an MPSP report reflects:

- **Operational Continuity:** It assumes that the business will continue to operate as it has, sustaining cash flows and customer relationships.
- **Revenue Potential:** The business's ability to generate income now and into the future, often factoring in growth trends, market positioning, and other revenue drivers.
- **Intangible Assets:** These include customer relationships, brand value, intellectual property, and goodwill, which play a substantial role in how a business performs.

See a sample MPSP report here: <https://www.businessandassetvalues.com/business-valuations>

2. Tangible Asset Valuation: Machinery and Equipment Appraisals

Certified machinery and equipment appraisals are a focused evaluation of a business's physical, tangible assets. These assets are integral to the operations but are valued independently of the business's ongoing cash flow or market position. Tangible asset appraisals might include:

- **Machinery and Equipment:** Items essential for production, inventory management, or service delivery.
- **Vehicles and Tools:** Any equipment used in daily operations, from transport vehicles to specialized tools.
- **Fixtures and Other Physical Assets:** Assets fixed to a location that might include shelving, installations, or production lines.

See a sample CMEA report here: <https://www.businessandassetvalues.com/faq>

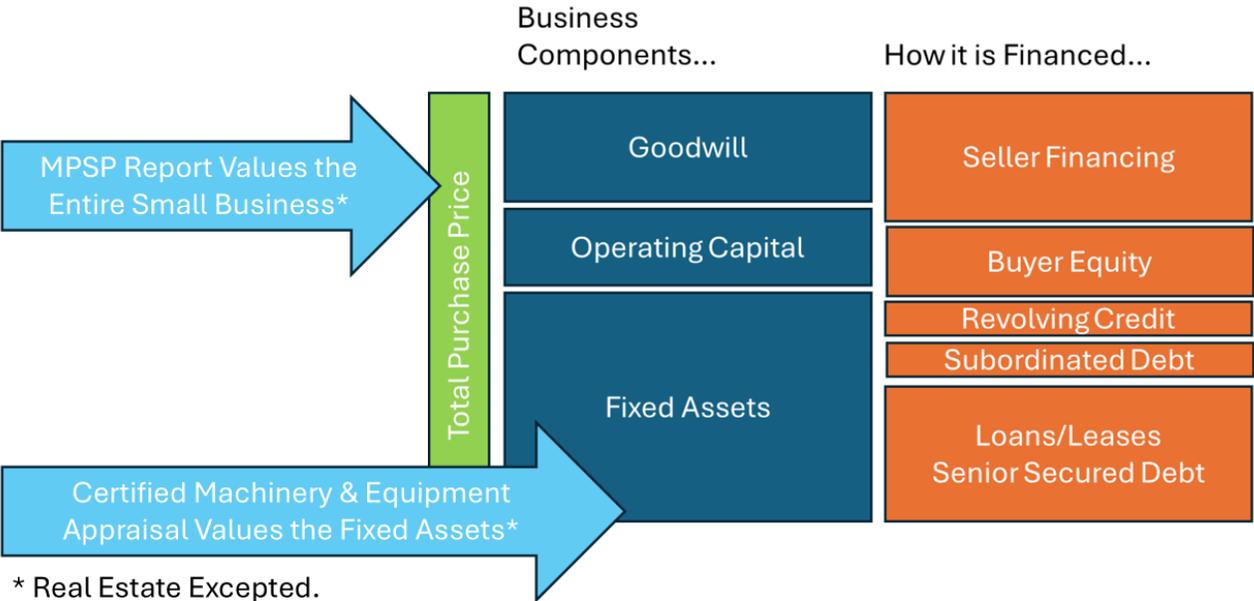
The value of these tangible assets is typically assessed at fair market value, reflecting what they might sell for in a standalone sale or liquidation, independent of the broader operational context of the business.

3. The Gap Between Business Value and Tangible Asset Value: Goodwill

The difference between the MPSP valuation (the business as a going concern) and the tangible asset appraisal is commonly known as **goodwill**. Goodwill represents the intangible value that makes the business worth more than the sum of its physical assets. This difference is significant for a few reasons:

- **Customer Loyalty and Brand Recognition:** Goodwill often reflects a business’s reputation, customer loyalty, and the strength of its brand—qualities that enhance revenue potential but don’t have a physical presence.
- **Operational Synergies:** A functioning business has value in its established workflows, experienced staff, and ongoing relationships with vendors and clients, which contribute to efficiency and stability.
- **Future Earnings Potential:** Goodwill is closely tied to the expectation of future income and growth, based on the foundation the business has built over time.

Goodwill is critical in business sales and acquisitions because it represents the premium a buyer is willing to pay for the business’s established position, reputation, and ongoing revenue potential.



Why Understanding Both Valuations is Essential

Knowing both the MPSP and the tangible asset value gives a well-rounded view of a business's worth and helps owners and buyers make informed decisions. Here's why this dual perspective is important:

- **Accurate Sale Pricing:** When setting a sale price, it's essential to factor in both the tangible asset value and goodwill to avoid underestimating the business's market position.
- **Financing and Loan Decisions:** For lenders, understanding the balance of tangible and intangible assets can clarify risk. Tangible assets may serve as collateral, while goodwill reflects the earning power and stability of the business. In some situations, a lender may also consider cash flow financing or subordinated financing for a profitable business where the value of the business is greater than the value of the hard assets alone.
- **Strategic Planning and Investment:** Business owners who understand the goodwill component can take steps to protect and grow this value, investing in branding, customer relations, or operational improvements that strengthen their market position.

Conclusion

Valuing a business as a going concern with an MPSP report and appraising tangible assets each provide unique insights. While tangible asset appraisals focus on physical items that support daily operations, the MPSP report reflects the broader operational value and intangible assets that contribute to future earnings. Together, these valuations help uncover the goodwill that sets a thriving business apart from its physical components, giving buyers and sellers a complete picture of what makes the business valuable.

For a deeper understanding of how these approaches can reveal the full value of your business, contact ALP Ltd. Valuation Services. We're here to guide you through the valuation process, whether for a sale, acquisition, or strategic planning.

Financing Goodwill in Business Acquisition

One of the reasons goodwill matters so much in a business purchase is that it can create a financing challenge.

When a buyer purchases a profitable business, the purchase price may be higher than the value of the equipment, vehicles, furnishings, inventory and other tangible assets. That difference is the goodwill. It reflects the value of the business as an operating enterprise, including its customer relationships, reputation, trained staff, systems and future earning potential.

Traditionally, lenders have been most comfortable making loans against tangible assets because those assets can serve as collateral. This means that in many business purchases, a lender may be willing to finance the equipment, leaseholds, or other identifiable assets, but not the entire purchase

price. When this happens, the buyer must find another way to cover the goodwill portion of the transaction.

In Canada, the Canada Small Business Financing Act program now allows some financing for eligible intangible assets and working capital costs. Under the current guidelines, term loans under the program can include intangible assets and working capital costs, with a maximum of \$150,000 available for those items within the applicable limit. This means that in some transactions, a portion of the goodwill-related value may fit within program rules, depending on the structure of the deal and the lender's underwriting approach. However, this does not mean that all goodwill can be financed under the program, nor does it remove the need for a lender to be satisfied with the overall strength of the transaction.

For stronger businesses, there may also be another possibility. Some lenders may look not only at the resale value of the assets, but also at the cash-generating ability of the business itself. This is often called cash flow financing. In Canada, BDC is one of the clearest examples of a lender offering this kind of solution. Other major charter banks will consider them as well on a size and industry-specific basis. BDC describes cash flow financing for business acquisition projects where the target company has demonstrated a consistent track record of positive and strong cash flow. BDC also describes mezzanine financing, also called subordinate financing, as financing that is not secured by specific company assets and is based on the historic and expected future cash flows of the business.

This type of financing can help bridge the gap between senior secured debt, seller financing and buyer equity. In practical terms, it means that where there is not enough tangible collateral in the business to support the full purchase price, a lender may still consider advancing additional funds if the business has dependable earnings and the overall situation is strong enough.

That said, when a lender is considering financing that is less dependent on hard collateral, other factors often become more important. The quality of the financial statements, the consistency of earnings, the experience of the buyer or management team, and the personal financial strength of the principals may all help support the application. A lender making this kind of loan wants confidence that the business will continue to perform and that the people behind the transaction are capable of preserving that performance after closing. BDC's published materials for customized financing emphasize strong management, quality financial reporting and repayment structures adapted to cash inflows.

This is one of the reasons why both an MPSP evaluation and a CMEA report can be useful in a business purchase. The MPSP helps explain the value of the business as a going concern, including goodwill and earning power, while the machinery and equipment appraisal identifies the value of the tangible assets that may support secured lending. Together, these reports help buyers, lenders and advisors understand both what the business is worth and how different portions of that value may be financed. That is fully consistent with how the report already distinguishes the MPSP from the CMEA and explains the role of goodwill in the gap between the two.

If your intention is to put a business up for sale, then the MPSP valuation is the report that will give you the basis for an asking price.

The Most Probable Selling Price Evaluation

How Small Businesses Are Valued: The Process Explained

Valuing a small business is both an art and a science, combining financial analysis with an understanding of market dynamics and qualitative factors unique to each enterprise. At Advantage Liquidity Partners Limited, we specialize in small business valuations to support sales and other critical transactions where an accurate valuation is crucial. Our tool of choice is the Most Probable Selling Price (MPSP) report, which reflects a business's expected selling price under typical small-to-medium business transaction terms. Here, we'll walk you through the MPSP process and how it sets itself apart from traditional appraisals. See a video showing a sample of these reports here: <https://www.businessandassetvalues.com/business-valuations>

What is the Most Probable Selling Price (MPSP)?

The MPSP analysis is more than just a numeric value; it's a comprehensive look at both the financial and qualitative attributes of a business. Unlike an appraisal, which often assumes cash-based transactions, the MPSP reflects the usual terms in small business sales, such as seller financing, contingent payments, and earnouts. This realistic approach acknowledges that small businesses rarely change hands with a simple cash transfer, adding flexibility and accuracy for both sellers and buyers.

Step 1: Financial Analysis and Normalization

The process begins with gathering the financials, including income statements and balance sheets. We enter this data into a comprehensive model and perform **financial normalization** (also known as recasting). This step adjusts reported figures to reflect the business's market performance under "normalized" circumstances, which means making adjustments to expenses like:

- **Owner's Salary:** If the business owner's pay exceeds the market rate for their role, we adjust it down to market value, reallocating the difference to business profit.
- **Family or Related Expenses:** We also normalize expenses that might include family members' involvement at non-market rates.
- **One-time or Non-recurring Expenses:** Adjustments account for unusual or one-off costs that don't impact regular operations, providing a clearer view of ongoing profitability.

Step 2: Setting Projections

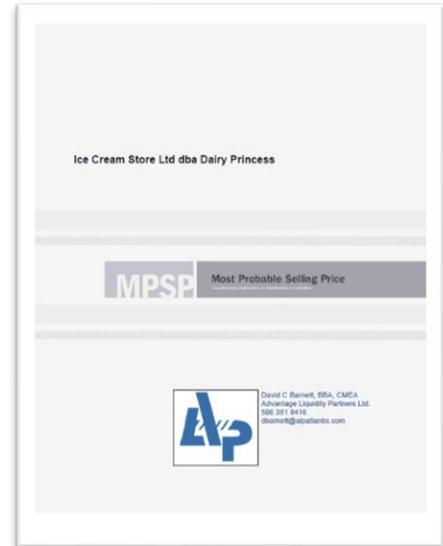
Next, we use current data to project future performance. This includes revenue growth, typically adjusted for inflation, and other expenses that may rise at a similar rate. Assumptions here consider elements like machinery reinvestment and operational capital requirements. For example, we might project that 1% of revenue will go into machinery each year, helping buyers plan for sustainable future operations.

Step 3: Transaction Type and Balance Sheet Adjustments

Whether a business is sold as an asset or share sale has important implications for valuation:

- **Asset Sales:** In an asset sale, the seller typically retains accounts receivable and settles payables, while the buyer brings in fresh working capital.
- **Share Sales:** With a share sale, the business's debt and cash might remain, but this depends on whether the buyer and seller agree on a "cash-free, debt-free" sale.

Each transaction type requires distinct adjustments to ensure the valuation accurately reflects what will be transferred and retained by each party.



Step 4: Benchmarking and Comparison

With the normalized financial data ready, we compare the business to industry peers using private transaction databases. Benchmarking allows us to evaluate performance across metrics such as gross margin and occupancy costs. For instance, if a business's wage costs significantly differ from industry averages, this might indicate potential savings or additional expenses for a new owner.

Step 5: Valuation Methodologies

Our valuation model uses various methodologies, typically a combination of income and market approaches, each weighted based on its relevance to the business type. For instance:

- **Income Approach:** This method considers expected cash flows, adjusted for risk.
- **Market Approaches:** These use multiples of seller's discretionary earnings or revenue factors, based on comparable sales data within the industry.

After applying these methodologies, we assign weightings, ensuring the final figure aligns with both the business's financials and market realities.

Step 6: Final Report and Value Presentation

The MPSP report combines all of these analyses, providing a realistic enterprise value. This report highlights:

- **Normalized financials** and historical performance
- **Projected growth and capital expenditure**
- **Key value drivers**, from location and market desirability to customer satisfaction
- **Transaction-specific adjustments**, outlining what is included or excluded based on the transaction type

The final report is thorough and includes a glossary of terms, methodology descriptions, and often an appendix with further insights into the industry's performance.

Why Choose the MPSP for Your Small Business Valuation?

Unlike traditional appraisals, the MPSP approach accounts for real-world transaction structures common in small business sales. It's designed to offer buyers and sellers a detailed, market-informed estimate that respects the business's unique attributes, giving everyone involved a clear and realistic view of its true market value.

Appendix- Frequently Asked Questions

Visit our website to see our currently available videos and a list of the top 40 questions we frequently answer: <https://www.businessandassetvalues.com/faq>

Video#1: Certified Appraisals- How they differ and what they look like.

What does a USPAP-Compliant Certified Machinery and Equipment Appraisal report look like?

What's the difference between a CMEA report and what an equipment dealer might create?

Video#2: Questions for the party ordering the appraisal.

What information do you need to begin?

How much does it cost?

What if we have no equipment list to give you?

Video#3: Questions for the equipment buyer or owner.

Do you need to come and visit the equipment?

Why do I need a Certified Appraisal?

Why is my banker asking for an equipment appraisal for the business I'm going to buy?

Video#4: Understanding small business valuations.

Who needs a small business valuation?

How I complete the valuation exercise.

What the final report document looks like.

