Arthur Hamel

Business Seminars

Interview Series

Art Hamel On Pricing Your Business: Why You Could Be Sitting On A Million Dollars (Or More)...And Not Even Know It

Michael Senoff Interviews Arthur Hamel

Michael Senoff's HardToFindSeminars.com

Dear Student,

I'm Michael Senoff, founder and CEO of HardToFindSeminars.com.

For the last five years, I've interviewed the world's best business and marketing minds.

And along the way, I've created a successful home-based publishing business all from my two-car garage.

When my first child was born, he was very sick, and it was then that I knew I had to have a business that I could operate from home.

Now, my challenge is to build the world's largest free resource for online, downloadable audio business interviews.

I knew that I needed a site that contained strategies, solutions, and inside information to help you operate more efficiently

I've learned a lot in the last five years, and today I'm going to show you the skills that you need to survive.

It is my mission, to assist those that are very busy with their careers

And to really make my site different from every other audio content site on the web,
I have decided to give you access to this information in a downloadable format.

Now, let's get going.

Michael Senoff

Michael Senoff

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Why You Could Be Sitting On A Million Dollars (Or More)...And Not Even Know It

I normally don't do this, but I have decided to take the "pricing" section of Art Hamel's business-buying system and make it freely available to the public. Why?

Because this section literally applies to everyone and anyone who currently owns a business or plans to start one some day -- even if it's a "kitchen table" business or small operation.

You see, once you learn Art's simple formula for pricing businesses...you'll know exactly how much yours is worth, and it may be worth more than you think. In fact, it could be worth five, six or even seven figures.

And even if your business isn't worth a lot of money now, you'll see how to make it valuable to buyers and be able to add whatever amount of value you want to it. In some cases, you may only have to make a few little "tweaks" and adjustments...and sell it for enough money to retire for the rest of your life.

That's no exaggeration, either.

Art's formula is so precise and accurate...people have been trying to steal it as their own so they can teach it for years. And until now, the only way you could learn these pricing secrets was by attending Art Hamel's high-priced business-buying seminars or buying his course. Are you sitting on a million dollars?

Find out in this incredible audio seminar. You may be sitting on a goldmine and not even know it. Make sure you download the PDF worksheets so you can follow along. This is not the kind of lesson you just listen to. Make sure you download the worksheets that go along with this lesson. They can be found here at the link below

http://www.hardtofindseminars.com/Art_Hamel_Interview.htm#Pricing

LESSON 5

In this section on pricing, we're going to get involved in the actual pricing of a business, a manufacturing company, and you're going to find that a lot of the basic things that we use in manufacturing in the future, you'll find will also apply when you go out and price a retail business, a service business or price a distributorship.

Now, the thing I want you to realize as you go through this section, we are not going to make appraisers out of you because it takes a lifetime to become a business appraiser. What we want you to realize we're going to be teaching you how to price a business.

Now, I want you to realize this program was developed by us many years ago. We have tried it for many years, and it works very well. The different offices that we have around the United States that are in the brokerage area where we list and sell businesses or do merger and acquisition also use this as a guide in pricing businesses.

One of the reasons that we developed this a number of years ago was because one of the biggest hang-ups that most buyers had when they were buying a business, they though they were paying too much. Sellers were selling businesses and thinking they were not getting enough money, and then we had our broker friends and consultants and attorneys and CPAs that were out there trying to price a business for their clients and found it was very difficult.

So, what we tried to do is come up with a mathematical method for pricing or arriving at a price for a business, and you're going to find if you apply it, you're going to find that in the beginning it's going to take you a little while to get it down pat, and by the time you've done it seven or eight times, we find that the average person can price at a business in about ten minutes.

So, let's get started, but let's go back and start talking about the past. We start thinking about the past years ago when we first started, we had a lot of rules of thumb, and what we had was we had a number of people out there that did not know a lot about business, and so what they needed was something to give them a magic way of arriving at a price. One of the things that were used quite a few years ago, and used quite infrequently today is a thing called the gross multiplier.

In a technique like this, a persona analyzing a business, would take the annual sales of the business, multiply it by this magic number they had arrived at by some mumbo jumbo, and then come up with a price. The only problem with this is this is not taking into consideration things like the profit, the location, things like this. These are all things that go into the value of the business or how much money it was making.

The next method that we run into is a thing called the net multiplier, and a net multiplier, you're going to find that the people analyzing using this method are taking magic numbers and multiplying by the net profit of the business to come up with a value. Although this does take into consideration a lot of the cash flow items of the business, it doesn't take into consideration, again, the value of the location, the value of the management team, the value of the employees, the consideration for how much financing you can get. So, there was a lot of considerations this does not take into consideration.

Net multipliers are still used to a large degree around the United States by a lot of people that have been in the business ten, 15, 20 years, but the thing we want to warn you on, if you decide to use these, you're going to find they are not very accurate, and in most transactions either the buyer or the seller ends up getting shafted. So, although some people may use these as a guide, what we'd like you to start doing over the next couple of years is get away from these techniques because of the technique we developed now, you don't have to use these magic multipliers.

Now, this thing we're going to be talking about on this tape has to do with a thing we call the Hamel Method because although we have these magic methods for arriving at a price that were used for many years, and as a matter of fact, I taught a lot of these over the years, I want you to realize, the thing we had trouble with about six or seven years ago in this country was the fact that we couldn't get a lot of buyers to get involved in business because they had this great fear as to what the price was or whether they were really getting a good deal or whether they were getting a bum deal.

All we needed was something that was simple, something that somebody could use that was doing this everyday, something that was very accurate, and also something for somebody that maybe wanted to price or evaluate a business every two or three years. We needed something basically that was something for a dummy you might say.

So, what we developed was the Hamel Method, and what we really did is we went out and worked with business appraisers all over the United States, and working with the business appraisers what we did was we sat down with them, we found out they had done it from the state of the art standpoint, how they evaluated businesses, how they were able to analyze the hard value assets, how they went out and analyzed the intangibles, the goodwill, blue sky, whatever you want to call it, and what went into that subjectively.

Now, you have to realize most of these business appraisers had ten, 15, 20, 30 years experience and they're using this experience to arrive at a value. They had guides they used, and all we did as we sat down with them over a period of a couple of years – we set up mathematical equations, and what we have done then is taken what is basically state of the art a few years ago, applied mathematical equations to them, and today what we have is a mathematical system, and all you're going to have to do as you go through this program on these tapes is figure out what describes the business you're looking at and using appropriate number. By adding up all these numbers that you end up with as you'll find later in the tapes, you're going to end up with a thing called a price of a business, and lo and behold, believe it or not, you're going to find as you go out in the real world, you're going to find these numbers do hold up and you're going to find that you're going to be able to buy a business at this level or sell at this level.

The only time that we have problems even today in our pricing versus the real world is an area of service businesses, and you're going to find in many cases when you're using this pricing system, our price or value will come up to a value I wouldn't say a lot less, but substantially less to a medium less than what the people are asking for the business, and what I'd like you to suggest is we've already verified this area. And, what we have is you are now going to get involved in a system that measures a service business accurately.

What you're going to find in the real world as you go out in the service area, you're going to find that service businesses are basically overpriced, and since they are you're going to find that you're going to have to get involved in more negotiation to get the price down to the right level.

As you go through this system also we'll do on the tapes, you're going to find that there's a number of things that are going to be exceptions. When we first set up this program mathematically, we set it up to cover maybe 98-99 percent of all the things you're going to run into, but you have to realize because of the variations in pricing, and also the variations in types of businesses you're going to run into, you have to realize that you're going to have exceptions.

You're going to run into things that are going to give you trouble. You're going to have to go to somebody that is more expert than yourself. It doesn't happen very often, but when you run into problems like backlog you're going to have to have some help in measuring the affects of backlog on the value of the business because let's face it, if you have a company with a backlog of orders of only $100,000 that company is not worth as much as a company that has a backlog of maybe $500,000 or a million.

Other things you're going to run into will be things like special contracts. The company will have a special contract. They'll have a special tie to a company. That gives that value also. Why? Because they have a basic market that they have control over, and with that control over that market, you're going to find that gives them basic sales and profit every year, which again adds to the value.

The last thing, and by no means the last thing, but the last thing we'll be considering today is this thing called the exceptional year, and we seen it recently in the automobile business. You see it quite often in real estate related businesses where you have extreme peaks and valleys, and you'll see gradual growth. The company will show sales the first year of $100,000 and then $150,000, then $200,000. Again, the profits going up at the same approximate level. All of a sudden although in the last year they had $200,000 in sales and maybe $50,000 in profit, the sales figure will suddenly jump from $200,000 to $800,000 and the profit will jump accordingly.

Now, the thing you have to realize is do not get trapped into pricing or valuing the business just based on that one year. One of the techniques used quite often by a lot of people is to take the average of the last three years. Others of us in the business, if you happen to have a business that has more than five years cycle, it could be the automobile business with six or seven years cycle. We will then take the average of that period of time. Please keep this in mind or you'll have a tendency to grossly overprice or grossly underprice the business you're looking at.

Now, let's get started now because if you're been following me on page 5-1, what I'd like you to do now is turn to page 5-3, and what we're going to have you do now, is pull 5-3 and 5-5 out of your book. Please pull those out of your book.

Now, what you have here is you have two different documents that are going to be describing a company called, "M Manufacturing", and on the first part of the pricing that we're about to go into, you're going to find there's two documents that you need for analyzing this business from this side.

Now, in the first part we're going to be analyzing a thing called hard value assets. Now, on M Manufacturing, the first thing you see on page 5-3 is the Profit and Loss statement. Now, early in this cassette program, we went through the Profit and Loss statement. What we're going to do now is take you through the Profit and Loss statement again, and show you how we use the Profit and Loss statement information to price or value a business. The other thing we're going to be using in the area of hard value assets is a thing called a Balance Sheet, and what you have is the Balance Sheet here for M Manufacturing Company.

So, if you'll just set these two on your desk or table, set these aside so you can refer to them, what I'd like you to do also then is turn to the page in your book 5-9. Now, 5-9 is the actual pricing sheet and a sheet that we're going to be using as a guide in this section, and what we're going to be doing now for the rest of this area, we're going to be covering a company called M Manufacturing. We're being covering pricing or the valuation of the hard value assets and then the Hamel Business Values on the other side of the sheet.

Incidentally, the Hamel Business Value is nothing more than the measurement of the intangibles. You can call it goodwill or you can call it blue sky. And, we'll be covering that a little later.

But, let's take the first part of the sheet first which is page 5-9, and what we've attempted to do for you here is we have broken this sheet into five section – Section One, Section Two, Section Three, Section Four and Section Five. What I'd like you to do now is start with Section One, and you'll see up in the left hand corner on this sample sheet you have here, we have Section One.

Now, Section One which is the total thing which starts in the upper left hand corner, and it says total sales down to the last item in Section One which says net profit. We're now going to put in here what we call the summary or summation of the Profit and Loss statement. We will have sat down with the owner or if you happen to be the owner of the business. You'll take the Profit and Loss statement usually for the last year that you have.

Now, if you happen to be in the middle of the year or toward the end of the year, what I want you to do is take the statement for the end of the last complete year that you have, and then later on in this program, I will show you then how to take the items that you end up with, and adjust them up to the next level or downward.

Let's start off by talking about the M Manufacturing Profit and Loss statement. First of all, in the last year, year 198x, we had sales of $600,000. So, under "Sales" in the first area, since we're all going to be making up a summary, what I'd like you to do is put down the $600,000. That's the sales for last year.

Now, what we'd like to do now is we're going to subtract this Cost of Sales because in order to have the sales of $600,000 what we did is we took materials on the second line of $150,000, we added labor of $200,000. Now, when you take the materials and labor and add those together, you get a total cost of sales. In other words, the total cost of the product that you manufactured for resale was $350,000.

The one thing I'd like you to keep in mind as you look at the labor in this area is the fact that in the labor area, this is the labor that we call direct labor, and this is the labor that goes directly against the product. If you would go back to the Profit and Loss statement on section 5-3, you would notice on Operating Expenses, that we also have in here a thing called Payroll, and I believe the number is $20,000.

Now, the $20,000 in payroll that you say in Operating Expenses on page 5-3 is the actual overhead, your office expense. These are the people that are working in your office.

The labor figure that you see on 5-9 under Cost of Sales which is a $200,000 labor figure are the people working on your production floor, and their labor is directly tied into the product.

So, what do we have under Cost of Sales when we're in a manufacturing company? We'll have materials – in this case $150,000. We add to that some labor, and we end up with a product that costs us $350,000. We then take the products during the year that cost us $350,000 in our shops, and we go out and sell them for how much? For $600,000.

When you get involved in businesses like a retail business, in a retail business we would not have labor because what we'd be doing basically as an example is we'd go out and buy a woman's dress. We'd buy it for $100. We'd mark it up then to $200. The cost of sales would be what? $100 or 50 percent.

Now, the thing you have to realize is in an area like that what do you not have? You do not have labor.

Going the next step, you're also going to be running into businesses called service businesses, and when you get involved in service, what are you selling? Your labor, and you're going to find in a business like that, you don't have material and you don't have any labor that you add to the material. So, when you're in a service business, you're going to find the cost of sales area or cost of goods area is going to be left blank.

As we subtract Cost of Sales now from the Sales figure, we end up with a gross profit of $250,000, and the reason I mention this, and we're going to mention it over and over again in this program, we're trying to help you become familiar with the different terminology used in the industry.

Now, once we have a gross profit of $250,000, a lot of you say, "Oh boy, we're going to put the $250,000 in our pocket." Well, that's not true because we're going to find that although we have the expenses from the manufacturing area subtracted out, we still have a few other problems. We're going to have to subtract other expenses from this businesses to end up as you're going to see here with a profit of $100,000.

Now, on these pricing sheets from here on out, we could have just taken the expense and just lumped it and ended up with a profit of $100,000 on this summary, but the reason we isolate a couple of things here is because of problems we have in analyzing businesses.

Now, first of all, what we're trying to do is isolate expenses that we have trouble with, and the first one is a thing called a manager's salary. Now, the manager in this business is being paid $40,000 a year. The owner does not work in this business. So, all we have is a manager. The manager's running it. The manager's paid $40,000 a year, and the owner of this business stops by occasionally. He don't have a major thing here.

Now, what we're trying to do – we've got to get back to the basic area. We've already talked about this before in the area where we covered the Profit and Loss statement. The only way you're going to be able to analyze a business effectively and compare apples and apples is you have to be able to analyze a business that shows a bottom line net, in this example of $100,000, after you have done one thing which means built in the manager's salary and then pushed back in all of the owner's perks and benefits. If you don't do that, you're never going to be able to compare apples and apples because one business owner will be taking out $20,000 for themselves. Another business owner pulls out $50,000. Another business owner pulls out $100,000.

Unless you can get back to the point where each business has been reconstructed so that we have taken the owner's perks and benefits and pushed those back in to adjust the profit and loss, and we've also backed out whatever the manager's salary is, you're going to find that you can't compare apples and apples.

So, what have we done here? We've isolated it. If you run into a sheet like this in working with somebody selling a business, buying a business, or even at a marketing session and the manager's salary has not been filled in – I just want to warn you – beware. Somebody hasn't done their homework or the numbers are not very accurate. In other words, you're going to be comparing apples with the Jupiter effect.

The next item we have here that we're trying to isolate is a thing called Building Rent, and the reason for this quite often when you're buying a business, there is real estate attached to that business, and what happens is the owners from the old school that don't have good CPAs or good tax advice will have their business and their real estate within one company. What will happen is if they pay off their real estate and end up depreciating or taking the ACRS on it, you're going to find when you look at the profit and loss statement, there is no expense or there are no expense items that reflect the ownership of the real estate, and what will happen is after they paid off the real estate, there's no interest write off.

You're also going to find after they've taken all the tax write-offs they can, there's also no depreciation or ACRS. So, what do we find? The owner's going to be telling you they're living rent free, and the crazy thing about it is here's a business that shows $100,000, and although we're paying rent – let's take an example where the owner owned the building. He was paying no rent to himself, and living rent free. You're going to find a lot of examples like this where the owner could take the building that he owns, go down the street, rent it out for somebody else for $200,000 a year.

Now, if this business had to pay $200,000 a year rent, it would be running in the red. In fact, what you have here is a business that really doesn't makes sense if you have condition. Why? Because if you could re-rent it to somebody else for $200,000, what you should do is close down your business, sell off all your assets, and rent it out to somebody else. Why would you want to make a $100,000 a year on a business and work a lot of hours, when you can close it down, rent it out to somebody else and make even more money than that? You're going to run into this quite often. So, don't be surprised.

Now, in this example we have a different situation. We have a building rent. They're paying a building rent of $10,000, but the reason we isolate that is the classic example that I've run into many times is you're going to find the owner is living rent free. You then decide to go in, and you take over the business. You decide you don't want to buy the real estate now, and you want an option to purchase.

So, you then sign a lease and pay $8,000 a month. The thing is you're paying $8,000 a month. You then come to me at the end of the year, and say, "Gosh, Art, I can't figure this out. The other owner was making $100,000. I feel I'm only making $4,000." You really are because you forgot to take into consideration the lease payment you're paying that the former owner wasn't paying.

Now, when I isolate these areas, I want you to realize because I'm not bringing up exceptions. I'm bringing up things that happen everyday all over the country. So, I want you to concentrate on these because this is where you make the most mistakes.

Now, the next area, the thing we call "Other" is only put in here for those of you listening to this that are nit-pickers, because what you want to do is have everything balance out. The Other is just put in there to balance out all the total $150,000 of expenses. After you get working on this I really don't care if you fill out that line. All it is, is a balancing effect to give us total expense of $150,000.

If you want to know where we got the total expenses of $150,000 from, if you go back to your Profit and Loss on page 5-3 under Operating Expenses, you'll see that we've given you a break down of all of the expenses that do make up the $150,000.

Now, if we now subtract the expenses that we have, and the gross profit we talked about, son of a gun, guess what we end up with? We end up with the net profit of $100,000. We're on our way. Now, all we've done, and again, you're going to say, "Gosh this might be confusing." All we've done is we've put down here a summary of the Profit and Loss Statement so we can refer back to it when we're doing it, and as we go on here you're going to see that we're going to build on this. We're going to build on the Profit and Loss statement we have here.

Now, we've basically covered section one, which is nothing more than what? The summary of the Profit and Loss statement. Now, as we start to go south or down the sheet into section two, we're going to get you involved in an area that we call "the adding back of the owner's perks and benefits."

I'd like to describe perks again. Perks we're calling the thing called perquisites. In other words, they are actual benefits that the owner takes out of the business that the owner is able to take out tax free. Now these are things you're going to build back in. Why? Because unless we do this, we're not going to know what the true profit of the business is because in this example here the business shows a profit of $100,000, but as you're going to find out there are additional items in here that are either you would call a paper write-off or maybe write-offs that the buyer is not going to take. But, the thing is we have to realize we have to analyze this business with $100,000 as this business shows plus we have to build back in all the what? All the benefits and perks the owner is taking out because if you're going to price a business in the United States today, you can price it on what the Profit and Loss says.

As I already told you in this program, the average Profit and Loss never represents what the business makes. All it represents is the lowest Profit and Loss for tax purposes, and so what we have to do is build back in the items to find out what is the little jewel really making.

Now, one of the first items that are going to go back in here is depreciation. If you look at 5-3 under Operating Expenses, you'll see the other owner has subtracted a thing called depreciation. In the new tax laws, this is called ACRS – accelerated cost recovery system. What we're doing is the government is allowing us to write off certain amounts of the personal property we have in the business. Again, in this example here we don't real estate so it happens to be depreciation or ACRS on the personal property in the business.

Last year, the owner took $30,000 depreciation or ACRS. Now, that's very interesting, but the thing I want you to realize we're going to be building this back in. Why? Later on as we get down to section four, we're going to then actually take into consideration the real depletion or the wasting of the equipment you have.

Right now, the deprecation or ACRS or the tax write-off that you have on your personal property is based on tables that the Internal Revenue has established, and you're going to find that sometimes it does adequately represent the amount of money you're going to have to put in to replace that equipment, and with the inflation we have today, you're going to find a lot of times it doesn't quite cover it.

So, what we're doing is we're pushing it back in. We're building it back in, and you can say if you want to it's a paper item, but it doesn't make any difference because what you're doing is pushing that back in because below in section four, as we continue on the price, you're going to find that we're going to make adjustments or figure returns on the same equipment based on the real wasting or what it really costs us. In other words, we're not going to use government tables. We're going to find out what the real number is, what the real world is. So, build back in the depreciation.

Now, the next item we're going to build back in is a thing called interest, and I'd like to state this now and I'll state it again later. When you're going to price or value a business, the thing you have to do is value that business free and clear. If you don't do that, you're going to find that it's going to be very confusing because although it shows the position of where the seller is right now and how much financing they have, you also have to realize that this business is being priced from the standpoint of the buyer looking at it, or the buyer being willing to buy it.

So, what we have to do is analyze this basically free and clear, and after you have analyzed the actual value of the business, then you can tie in what the financing is and what it does to the cash flow, but what you have to do basically here is go free and clear.

So, what do we do? We take the interest payments that have been paid and we push this back into the business because the interest payments that have been paid by the seller will not necessarily be the same interest payments that you have, and if you're the buyer and you're looking at it from that standpoint, you want to be able to look at this manufacturing company from all different sides to see the same picture.

So, what do we see? We're pushing back in the interest. We're pushing it back in so we'll make it free and clear.

One of the next items we have is something that a lot of people are not aware of, and very few people ever take into consideration, and that's called a non-recurring expense. In this business in the last year, they had an expense of $10,000 that came up on time. If you don't build this back in, what you're going to find is you're going to be pricing the business based on a condition that only happened once. You have to price the business based on what the normal conditions and operating parameters are.

The other thing is and we don't have this in this example, you better beware of another thing called, "non-recurring income". You may find that you are doing work – sheet metal work – and normally every year you have certain jobs. In the last year, you may have found that you had one large job that's not going to come back again and it's the thing that took you from $200,000 in sales up to $800,000. Why did this happen? Because we had a single item that's not going to occur again, it's non-recurring. You have to be careful number on not to price or value the business on a non-recurring large amount of income, and also beware especially of a thing called non-recurring expense, and how are you going to dig you this out? We're going to be showing you this in this program.

As we add up these different items, these different items come to $50,000 which means we end up with a real net profit of $150,000. As you go out into the real world as we've discussed earlier in the tape, you're going to find the number that we have here is really on the low side because we have found, and again not taking the example of $100,000 – I'll restate what we talked about before. We run into a business owner paying tax on $50,000 we usually find there's some additional perks and benefits in the range of $100-$150,000. The more profit that the business pays tax on, the more perks and benefits we generally run into. So, don't be surprised at the large numbers, just go in and do your homework and build it back in.

Now, when we first started we had a business here that showed a profit of $100,000. We now have gotten it to a point building things back in where we have a profit of $150,000, and on this we're going to start to base the value of the business.

Now, before we go any further in this area on the profit, the thing we have to start to tie in now at this time is page 5-5, the Balance Sheet. In other words, the Balance Sheet is the thing we already discussed in this program, and what we're going to be talking about are the hard value assets of the business because the two basic things that make up a business is A-hard value assets – the value of the cash, the accounts receivable, the inventory, the equipment, all the things like this. These are hard value items. These are things you can go out and touch, put your arms around, hold. It's easy to give values on. Buyers and sellers don't disagree on these very often. Again, the disagreement is a lot less than you have in the other areas.

The other thing that makes up the value of the business and there's only two basic things. One is hard value assets, and the other things are the things that you hear about and you probably call them goodwill. You call them blue sky, or you can call them the intangibles. And, again, we'll get into the second part of this later in the program, but let's take the balance sheet now because one of the first things we have to analyze in this first sheet here on this first side is what are the hard value assets? What is the buyer getting when they buy this business? What is the seller selling? What are the basic items of equipment, hard value assets?

Now, let's start with the first on here, and look at the first asset, and it's called Cash on Hand. That's the amount of cash that this business had in the bank or on hand in other types of accounts that day which happened to be December 31st, 198x.

Now, keep in mind we are pricing or valuing a business at a date other than the date we're buying it or selling it. We're also pricing this or valuing it based on numbers that are not going to be the same numbers the day we take over. So, keep that in mind also. We'll talk about that later.

Now, first of all in cash on hand, we have $50,000. now, as you put it on the sheet under value under assets, remember we're putting down the assets that you are going to receive when you're buying the business, or if you're the seller, these are the assets you're passing on to the other party the buyer. If the first item is a thing called cash, that means the buyer gets the cash at the close of the transaction. Now, you're saying, "Why would anybody leave cash in a business? That doesn't make sense." Well, later on we haven't gotten to that, but as we turn over the sheets we're looking at right now, you're going to find that you're looking at a corporation. In fact, if you'd like to right now why don't we just take one of the sheets and flip over 5-3, and look at 5-4 and up in the upper left hand corner where it says Business Opportunity Owner Summary Statement in the left hand area the first thing it says is company name, business name – M Manufacturing, M Company. The type of business is manufacturing, and it says the business form is what? It's a corporation.

We've already talked about the different forms of ownership earlier in the program. What I'd like to do now is talk about another thing we haven't discussed yet in the area of corporations. When a business owner has a corporate form of ownership, you're going to find over 50 percent of the time the owner will leave the cash in the corporation when they leave.

Now, let's explain this because there's no free lunch in business. The reason the owner leaves the cash in the corporation is they usually have sat down with their CPAs, accountants or tax advisors and the tax advisors have said, "You have two ways to go when you settle this company. You can sell the assets and liabilities to the person buying it, or you can sell the stock, since it happens to be a corporation. If you elect to sell the assets and liabilities, you're going to have pay capital gains rates on part of it, and unfortunately ordinary income on part of it." That's not too good for the seller.

So, what happens is the seller will say, "What else can I do." And, the CPA or tax advisor will then say to the seller, "Why don't you consider selling the stock? If you sell the stock, you'll pay capital gains on the total gain of the stock and you don't have to worry about the ordinary income." That's the good news.

What you're going to find then is as soon as the person elects to go with the sale of the stock, they will find that if they try to pull cash out of the corporation while they're doing this, they're going to be taxed heavily. So, what would they rather do? They'd rather receive cash for their stock, and the leave the cash in the corporation. Why? It's beneficial to the seller tax wise. There's no free lunch. You're doing it for that reason.

Now, the other I'd like to mention at this time, this happens to be a corporation, and again over half the time they'll leave the money. How do you find out if they'll leave it or not? Ask the seller. They'll tell you.

Now, the other form of ownership you're going to run into and they'll be like this is a thing called sole-proprietorship. Not in this example, but when you run into the sole-proprietorship, you're going to find that the owner has no reason to leave the cash in. Would you like to make a guess to how often they're going to leave the cash in there? Never.

Now, again, if they had one that had $50,000 cash in it and you gave them $60,000 for the cash, they might leave it in, but again in all the years I've been doing this, I've never seen an owner in a sole proprietorship ever leave the cash. I'm sure I never will. So, you don't have to count in it. But, in a corporation, ask and you're going to find in many cases you're going to have $50,000-$100,000, whatever the amount happens to be. But, do ask right in the beginning.

The next asset we have on the second line or if you're looking at your balance sheet, is a thing called accounts receivable. We've talked about this already, but let's review. Accounts receivable means that people have come in to the business that the owner has here and says, "I don't want to pay cash. How about some financing?" The financing becomes a thing called accounts receivable, and what you're going to find here is you have accounts receivable of $150,000. You're going to say, "Well, is that significant?" Of course it is.

You have a company here that only does $600,000 a year in sales and you have taken $150,000 of your assets, and you let somebody borrow it. I mean, you're in the financing business. In fact, you're almost more in the financing business than you are in manufacturing. I'll tell you something, $150,000 of financing of money of yours as an owner that you have to put up to finance things is horrendous. It can sink you company. In fact, these are things that sink you when you have bad times. In fact, they'll even sink you when you have good times.

What I'd like to do at this time, if you'll just consider the receivables are $150,000, and $150,000 of receivables are choking you because you're in the financing business. You have a financing subdivision. How are you going to take the pressure off? What I'd like you to do, and again, we're going to go a little out of line. We're going to cover everything. I'd like you to go down under liabilities, under current liabilities, and there's a thing there called Accounts Payable. And, if you'll also look at your sheet 5-9, your pricing sheet under liabilities you'll see Accounts Payable of $100,000. Now, what does that mean? That means that when we get involved in this business, if you happen to be the owner, you're going to find that although you have the big hand on your neck strangling you with $150,000 of accounts receivable, on the other hand you have good news, and the good news is that you're going to have suppliers and vendors come along with people that you're doing business with – friends of yours, co-business owners – and what they're going to do is provide you with financing. Again, they love to have cash, but a lot of them are going to allow you to pay in seven days, 14 days, 30, 60, or 90 days, and what this does is release the noose or the fingers from your throat, and how much has it released? $100,000.

Now, what you're going to find then if you want to keep business very simple, you're not in the financing business for $150,000. You're only in the financing business for the difference between the accounts receivable and the accounts payable. So, how much are we being strangled by now? $50,000.

You're going to find as we go through this program we're going to be teaching you, number one, you are now in the financing business for $50,000. What happens if we're going to be able to show you to balance out the receivables and payables? Who's in the financing business then? No one. Supposing we're able to show you in this program how to make the payables larger than the receivables. If the payables are larger than the receivables, who's going to be in the financing business? That's right, the other party, and you're going to find for every dollar after you take over a business that you put the other party in the financing business, you will have one more dollar in you bank account that is yours to spend and use as working capital. Although a lot of you think this is done with mirrors, as we get into the sections in this book that have to do with financing, we're going to show you step by step how to do this, and once you do this, you're going to find this is going to help you with a lot of your cash requirements, you're working capital requirements, and you're going to have this financing available to you in your business at no cost.

Now, how is this going to help you? Number one, all of your competitors are going to be out in the financing business. You're going to find if you listen to what we teach in this program, the other parties going to be in the financing business, and when push comes to shove and you get involved in a recession, you get involved in a depression, you're going to find that the other people are in the financing business, and you on the other hand are going to have their money in your bank account. He or she who has the money in their bank account is who survives. We'll show you that again later.

Now, one last thing, I always forget to do this on the accounts receivable. We mentioned this once already, I want to mention this again because in this tele-program, I'm going to mention it four or five or six times because it's very important. In fact, I consider the receivables and payable two of the key things for buying, running, or getting involved in business. I don't care if you want to own a little donut shop or you want to buy General Motors. You have to understand this because this is one of the basic things that make up a thing called the cash flow. Again, I'm not talking about the bottom line cash flow. I'm talking about the way the money flows through the company.

Now, when you start to get involved in accounts receivable, a lot of people are going to tell you when you're selling your business, they want to keep their receivables.

They're going to tell you they want to keep their payables. As you get involved, I want to tell you most of the time, you want to take over the receivables. As you go through the rest of this program, it's going to become apparent why you want to do this because some of the best financing you're going to find is available in this area.

Now, the first thing is on receivables, there are going to be accounts receivable and not collectable because when you're in business and people owe you money, some of them pay you on time, some of them pay seven days late, 30 days late, 60 days late. The later the time becomes the less chance you have of collecting. So, what you're going to find later in this program is we're going to do a thing called aging. In fact, we've already talked about it once in the area of balance sheet, and what we're going to do is we're going to take you through a thing called aging, and again, aging means that we actually list the different accounts receivable in this company. We actually analyze those to see if they're current or if they're past due, and what we try to do is not buy the ones that are past due. Again, we've already talked about the exception to that.

Now, since we're only buying the goods and letting the seller or former owner keep the other ones, the next step we go to – we'll be talking about this later – in the offer to purchase, when the buyer buys it, we also build in a paragraph that state that the seller guarantees the ones that you're taking over, and the seller not only guarantees, but the seller will allow us to subtract the amount that we haven't collected from the next payment that we make, and you'll see this later in the program.

Continuing on now, we're talking about the next category and the next item on your balance sheet, and we're going to talk about a thing called Inventory. Again, this is another area that we talk about a number of times. In other words, we're going to go through inventory a number of times over and over again.

Now, on the inventory. We're talking about inventory cost of $50,000. In other words, the person that owns this business went out and bought this inventory, and they're reselling it to you at their cost.

Now, you're going to find that this is what most business owners do. What you have to do is beware of those business owners that want to sell you their inventory for what they paid for it plus 50%. If they do, I want to ask you a question, are you paying wholesale or are you paying retail? And, incidentally, we don't see this very often in larger companies, but in smaller retail businesses, businesses that are Mom and Pops making under $50,000 a year net, we find a number of business owners do this, and what they're doing is they're trying to show their first profit they've ever shown in their business by ripping off the buyer. So, what we're saying is we normally buy it at cost.

We've already mentioned this before when we were going through the balance sheet, but let me restate this. We very seldom take this inventory because when buyer and seller get together to take inventory, if it takes more than 40 seconds, they tend to fight. So, what we do, and again I'm repeating what I said before, we like you to use and we recommend that use the inventory companies. They're listed in the yellow pages under "I". They come out, and they do a very nice job. They're professional in these areas, and their cost is not very high.

I want to repeat one thing when you use these companies. They're also bonded which means when a mistake is made, they will make it good. And, why do we do this? I'm restating a point – the buyer, I don't care how sharp they are in the business, are usually not as sharp on the inventory as the seller. This, then, gives the buyer and additional edge because they have this group in there that knows that inventory or they're taking inventory very well. If a mistake is made then, the people that have taken the inventory will make it good. They will cover whatever mistakes they have made. So, it's a good way to go. So, we're buying the inventory generally at cost.

The next thing we run into here getting out of the current asset area, is fixed assets, and if you're looking at the next item on your pricing sheet or on the Balance Sheet on 5-5, the next item is the equipment, and what we have here is equipment and it's priced at $40,000. Now, when you start to look at equipment, what value are we using because a lot of people are going to come to you and say, "Use a book value." You're going to say, "What is a book value?"

Well, a book value basically as we stated before is what the value is for tax purposes. In other words, they bought the equipment for $80,000 a couple of years ago. They've taken depreciation and the ACRS over the last couple of years, and now the equipment's only worth $40,000 from a tax standpoint. That does not mean that this is what the value of the equipment is.

Now, what I'd like you considering doing is one thing. I'd like you to realize that when you go out in the world, there's going to be two extremes that people that are going to give you values on equipment.

Number one, the first on e you're going to run into is going to say, "Hey, I bought it for $80,000. It got depreciated at $40,000. The book value now is $40,000." Say, "Hey, that's great." On the other hand, you're going to find a group of people, and they went down to Charlie's Junk Yard last week. They bought this equipment for $200. They have now marked it up to $40,000. Why? Because everything goes up in value. Neither approach is accurate, and what I'd like you to do is I'd like you to go out to the equipment company that supplies you with replacement equipment in this industry, and they will give you an appraisal on this equipment that you have. What do they charge? Normally nothing. Why? There's no free lunch. They want to sell you more equipment. You're also going to find that they have a book similar to the Blue Book that they have in the automobile industry. It may be chartreuse, green, yellow – who knows, but you're going to find they have a book also that gives the values of the used equipment that's associated with the equipment that they're selling.

So, you're going to find that it's easy and they're not going to charge you for it. So, do find out what the equipment's worth because you're going to find in the past depreciation was a legitimate thing. You'd buy equipment for $80,000, and after a couple of years it wouldn't' be worth more than $40 or $20, but today with the inflation that we've had in the last few years, there's a lot of equipment out there that you're going to run into, and the equipment is worth a lot more than what they paid for it. You're going to find a lot of value in this area. In fact, this is an area that you like to contact me on all the time because you say, "Gosh, I'm buying this business here, and the business – the owner wants $100,000. The equipment's worth $200,000." What I'm telling you is when you run into things like that, what you've gotten is what we call a good deal. So, analyze it, get as much information and possible, and get as accurate appraisals as you can to hard value assets. Don't go out and just wing it because if you wing it you may be making it plus or minus $100,000. That's a lot of money when you're pricing or valuing a business. So, get as close as you can.

The next area we start to get into is a thing called the liabilities because when you're going out to buy a business, you're going to be able to buy it for the assets minus the liabilities. So, you better get the liabilities in there accurately and make sure you're not paying for something that doesn't exist.

As we start to look at this area, the basic one we have is the accounts payable and we've already discussed that, but you could have other things like taxes payable. You could have accrued salaries, and other different items under liabilities. Each one of these things you take on make sure is a real expense, and keep in mind as you do this, if you happen to be the buyer, each one of these items that you do assume do what to the value your paying? Lower it.

Once we've analyzed these, simply take the assets and subtract the liabilities. We end up with a total value of how much? $190,000 which is basically the net worth of the company. This is the net worth of the company, the book value. This is hard value assets that we're talking about right here.

Now, at this point, what I want you to realize is what we have done here is just put a summary of what? The balance sheet. The different hard value assets. Nothing magic about it. I just tried to educate you again a little on the different hard value assets.

Now, we covered Section Three. What I'd like to do now is swing over into Section Four, and talk about the area on the front part of 5-9 that is the most difficult. You're going to have to go through this a number of times. You've going to have work a number of businesses before this is going to start to sink in, but Section Four is what we call the adjustment and the profit for the cost of return of the following items, and what you’re going to find is when you get involved in business and you have money invested in cash, this is your money. If you have money invested into accounts receivable, these are dollars that you have put into that company or you have in that company that you could have placed elsewhere.

Quite often, you’re going to find as you get involved in a business, as you go on, in the beginning you’re not going to have a lot of profit. As you start to generate more and more profit, what the average American businessperson does, because it’s the American way, is they plow all the profits back into the business, but the thing that’s wrong is – there’s nothing wrong with plowing back profits – the thing that’s wrong is you don’t keep track of what you’re company’s paying you.

If you’d made a profit last year of $100,000 or pulled out $100,000 cash, and the company then has a need for $100,000 to buy brand new equipment, if you’re going to replace that equipment and put that money back in the business, what return are you going to get? I mean, if you can go out to the marketplace and get $10,000 on that money you have or $15-$20,000, why would you lend it to your company.

In fact, right now I want to develop a hard stance which is in analyzing or even running your companies, you don’t put the money back into the business unless the company can justify it. If you don’t do that when you get involved in business, you’re going to find every one of your employees coming to you and saying, “Let’s buy this new piece of equipment.” Well, if it’s replacement, fine, but if you’re buying something that’s supposed to speed up production or you save time. If it can’t justify the cost you have and the return you should be paying yourself on the money that you’ve invested back in your own company, why are you doing it?

One of the classic examples we run into may help you. Now, this example here, we don’t have this. We have real estate, but the real estate’s owned by somebody else, and we pay them in rent. We have a lease payment $10,000 a year. But, suppose in this example we did have real estate. We owned the piece of real estate.

Now, which way would you go? Would you leave the real estate in the company and live rent free or would you do the thing that's smart tax wise and also psychologically? And, that is to take the property that you have, the real estate, move it outside the company, and your company make lease payment to your other company. You'll find it not only benefits you tax wise, but you're going to find it benefits you psychologically. Why? Because your company is paying a legitimate rent.

Now, the money you've invested in real estate most of you have been brainwashed to the extent that anytime you invest in real estate and you also have a company, you know that you should pay yourself for rent because if you invested X number of hundred thousand in this piece or real estate, your company should pay your real estate division, you real estate profit center if you want to call it that, a return because one should pay a re turn to the other. Each one should pay it's own way.

Now, most of you are willing to do that, and you say, "Hey I've got a couple hundred thousand invested in real estate, so I should pay myself a return of a blank amount of money." Great, the thing that really gets me is as soon as we take the same amount of money and invest it in some other asset. You don't want to pay yourself. What's so sacred about real estate? What we're talking about, real estate's just a vehicle. I don't care if you invested that $100-$200,000 in real estate or if it's invested in cash or receivables or equipment, whatever it happens to be. You have to pay yourself a return.

As you start to analyze the business, you have to realize if you want to compare a business like this to a service business, the service business would probably have no assets. I mean you have one orange crate, two pencils, all leased. So, you don't own anything. So, what happens is you'd have a service company making $150,000 with no investment in assets. You don't have to replace the assets which means $150,000 you're going to get to keep.

In these other businesses, you're going to have to realize, if you put this money in, you're going to have to pay yourself a return, or if you have to go out to the marketplace to borrow this money, those banks are going to want to charge you interest. I don't care what way you look at it, you have to pay a return.

Now, let's start to struggle through this, and if you have trouble with this I want you to keep in mind, if you were to go out and mail from one of those beautiful packages from one of the larger merger and acquisition companies in the United States on some large company, they would have a section in their package on that business for sale on their evaluation that had to do with Section Four.

In fact, when you look at Section Four which is on something has a big probably four postage stamps, the large merger and acquisition people and the MBAs that work for those companies, you're going to find that they have devoted 45-50 pages to this one little area. So, as you go through it and have trouble with it, remember, the big people do also. That's why they spend 50 pages describing something because if it were that easy they could describe it in one. I'd also like to add that if they understood it, they could describe it in one.

Looking at Section Four now, let's start at the top here on this area, and what we have is equipment. Now, if we look at the equipment that we have in this business, we have $40,000 in equipment. Now, how are we going to figure what kind of return we should pay if we have invested the $40,000 ourselves - we put the $40,000 in the business in the equipment. Now, how much does the company pay us for the $40,000 we invested there?

What you have to do is realize that most companies if you go out to find out what the going rate is, they're going to quote you at prime plus a certain figure. In this example here under equipment, you'll see written there P+3. That means prime plus three. At the time this example was made up, we assumed a prime of ten percent. Do not worry about what the example is showing you here because as soon as you go out into the real world and start to analyze business, what I want you to do is call a lending institution, any lending institution, do it in the city that you happen to be in that day and ask them what the rate would be to borrow money in this area.

Now, you're going to say, "Well, why do we use a bank lending rate?" Well, the thing you have to realize is if you're going to take $40,000 of your money from your bank account and put it in this company, you're going to say, "Well, I'm only getting a certain percentage, under ten percent. I'm getting eight percent. I'm getting five and quarter, five and a half percent. That's the only interest I'm getting so, if I just get that back, that should be good enough." No it isn't because what the lending institutions have done is build in your rate plus also add in what another factor for the risk factor, and what you have to realize is although you might think that you're the best owner in the world and your company is the best in the world, you have to realize that we have to build a risk factor in if we're going to loan money back to this company to figure the return.

Now, on the equipment of $40,000, when we start talking about prime plus three, we've talked to the local organization, and again I want to restate, do not memorize these numbers because in any day in any city, you can call these different lending organizations – banks, savings and loans, whoever happens to be doing the financing – and find out from the what their rate is that day. They'll give it to you verbally over the phone. So, don't memorize this.

In this example here, again, we are assuming a nice even number of ten percent since it is a number that we have not run into very often. Let's say we have ten percent this day, prime, that's what they quoted. You find the bank of lending institution would then quote prime plus three based on the risk factor of this type business which means they would want 13 percent interest. That means that this year that you're going into, it's going to cost you $5,200 because if you find in this business that you have $40,000 of equipment, you've have had to either borrow at 13 percent or put your money in at 13 percent which you'll be doing later as you start to make money. You should subtract from the $150,000 the $5,200 because it's just like paying rent.

If this happened to be rent on this equipment, this is rent that would be going out of the company. It'd be repaying yourself or if you want to consider it another way, the company really isn't making $150,000. It's making $150,000 minus the $5,200 they should be paying interest to somebody, a bank, or the return that they should be paying to you, the owner or the person that invested the money or assets in this business. And, again, you have to develop and understand this philosophy and it's going to take you a while, but once you do you're going to find that you're not only going to do a great job of analyzing businesses pricing wise, you’re also going to be a fantastic owner because you’re going to understand the basics of what makes a company work. It’s not that difficult.

The next thing you have here is the inventory, and if you look over, you’ll see the inventory was $50,000. As we call lending institutions, they quoted prime plus two on this which was 12 percent, which means if you take this it’s going to cost you $6,000. I mean it’s going to cost you $6,000 for just the return on the interest you’re going to pay on just this. So, it’s $150,000 minus $6,000.

These numbers start to add up. In fact, you’re going to find a lot of large companies will show $150-$200,000 net profit and when you subtract the return, they show nothing down below. Are those companies you want to get involved? No way.

Now, you have inventory here and it’s costing you $6,000. Do you know the thing that’s really fascinating here? You’re going to have $50,000 in inventory. Supposing we’re going to be able to show you ways to own $50,000 inventory, have it in there – excuse me, I want to stand corrected on saying own – suppose you have the $50,000 inventory in there and suppose the $50,000 is available and suppose you don’t own the inventory, suppose somebody else owns the inventory. It’s like owning one of these big furniture stores and they say, “We have six million dollars in furniture.” You go in there and say, “My gosh, how can you afford so much furniture? How can you carry so much on the books?” They’ll laugh at you. They don’t own any of it.

Later in this program, we’re going to show you how to have as much inventory as all of your competitors and how much are you going to own? None of it or very little of it, and again, as you do this, you’re going to find asset by asset although the person that owns the business today has all this invested, by the time we get finished with you on this program, you will find that you don’t want own anything in the business you’re involved in except what? The cash flow. Let everybody else own the equipment, the cash register. All you want to do is own money, and the people in this world that make the most money are the people who only own the money. You don’t want to own these other things.

Next area, the receivables – now when we start to think about the receivables, and we've talked about this before. The receivables amounted to $150,000, and we said we're in he financing for $150,000, but we don't look back later and subtracted out the thing called accounts payable, and what we're saying was we're really not in the financing business with $150,000. We're in the financing business to the difference between the receivables and the payables.

So, it's the accounts receivable of $150,000 and the accounts payable were $100,000, that means we're in the financing business for how much? $50,000, fantastic. So, when we go to the bank or the lending institution, they'll quote prime plus three. You've got 13 percent. Again, this comes to $6,500. Now, remember we're not multiplying by the $150,000 or $100,000. We're multiplying the 13 percent by what? The difference between the receivables and payables, the amount that we're in the financing business for, which comes to what? $6,500.

Now, supposing later as we go through the program, we're able to show you ways to balance out the receivables and payables? Well, if the receivables balance out the payables, do you have to pay out $6,500 next year? No way.

Supposing we get to the point where we show you how to make the payables larger than the receivables – if this number is a minus figure, because you're in the financing business, what happens when we show you how to put the other people in the financing business? It becomes a plus.

I just want to make one comment here. We're now looking at pricing a business, but for those of you interested in buying businesses that are going through this program, I want you to realize that you're going to be able to in the month, two, three months after you take over your business – take a business that you're paying X number of dollars for, and add 20, 30, 40 percent to the value just by the things I'm showing you right here. You don't have to get out of your house. You don't have to get out of your kitchen. You don't have to do anything. You don't have to be creative. You don't have to increase your sales, and you'll find that if you want it to turn around a couple of months after you bought you can then sell your company for 40-50 percent more than you paid for it with only these techniques we're about to talk about here.

The next area is a thing called working capital and although most people worry about working capital and think of it as the most difficult financing to get, it's not true. You're going to find working capital is the easiest financing to get as you'll see later in the program. You're also going to find in most cases, it's the least expensive type of financing.

In this example right here, again we go to a lending institution. They quote us prime plus one, P+1, and again, as in the example, we had assumed ten percent prime rate at that time. You're going to have to go back and adjust it based on what it is today. It comes to 11.

We take the 11 percent times the $50,000 we have involved in cash in this business, and it's going to cost us $5,500. Or, if you've gone to a lending institution, you're interest alone or the return you have to pay is how much? $5,500.

Once we add up all these adjustments or if you had gone to a lending institution and bought this money, this would be your interest deduction. I mean, this is real money. You're going to find $150,000 subtracting the $23,200, gives us an adjusted net profit then of $126,800.

I'm going show you in a minute how to use this, but I want to mention a couple of things. First of all, if you're in this area and you have an adjusted net profit of $126,800, you're fine. But, supposing you have adjusted net profit of zero. Do we go any further? No, because if you have a zero adjusted net profit here, what it really means is if you go over to your right here to total value, this company is worth max the hard value assets of the company because the adjusted net profit comes up to zero, it's not worth anymore than that.

I don't care if they show $100,000 net on their statement or whatever. It's not worth anymore than the hard value assets because the company really isn't making money. They're only kidding themselves.

Now, it could be worse. Supposing the adjusted net profit comes to a zero figure. That means that it's worth $190,000 minus some figure. If they have had an adjusted net profit, if you went back two or three or four years, you may find that they've had such a bad run on the company or they have so much equipment on the company that if you take the adjusted net profit over the last three or four years, you may find that the true value to the right minus the negative figures for the last couple of years will give you a zero number or a minus number. What would that mean? That would mean the seller of the business should give you all the assets as a buyer and then add cash. In other words, they should give you money to take it off your hands. I want you to realize though in the real world they're not going to do that, but what we want you to do especially for a buyer is walk away. If you're a seller, I suggest you work on correcting your problems before you sell them because you have a business that unless you find somebody that doesn't what the heck they're doing, somebody you can rip-off, you're going to find the average knowledgeable buyer is not going to buy this company.

What you do now is move these numbers down below and if you'll take the $126,800 and move it down to Section Five where is says Hamel Business Value equals. If you just go across, you'll see you have $126,800. You're putting that in there.

What I'd like you to do then is going over to the right is take the value that you come up with before from your Balance Sheet of $190,000, and you move that down under what? The total value.

Now, what we have here if you want to look at the statement, it says Hamel Business Value equals total value plus weighted business values times the adjusted net profit. The Hamel business value or the value of the business you're about to come up with in this program is going to be equal to two things.

Number one the $190,000 which happens to be the hard value assets or the assets you can clutch and feel, and these are the assets from the balance sheet. That comes to $190,000. Then, the other half of it that we're about to go into which is to the right of the $190,000 are the things we call the intangibles. What's the value of the intangibles? What's the value of the goodwill? The blue sky?

Whether you call it intangibles, goodwill or blue sky, everything to the right of $190,000 is how we arrive at that, and what you're going to see is we have a value of 3.39, and you say, "Where did that come from/" Don't worry about that. We're going to arrive at that on the backside, as we go in and try to figure out what the value is of what? The value of the goodwill, the value of the blue sky.

Now, what you're looking at here if you want to look at the value of a business, when we analyze the value of a business, the business is worth the hard value assets – in this case $190,000 – and also so many years earnings. And, that's what we're looking at here. We're looking at, we're going to end up with an answer here of 3.39 million year's earnings are adjusted for the return, and that's what it's based on. It's hard value assets plus what's the value of the cash flow, the location, the management and all these other areas.

Now, the thing I want you to realize as you look at this. As you go out and compare what we're doing here with other systems that are used by other people all over the country, whether it's IRS or Bank of America program, the only difference between our program and their program is in certain areas where they basically tend to throw a dart at the board, or use subjective judgment, we have arrived at the figure mathematically, and you're going to find because we have done it mathematically, we are not only more accurate, but we have answers that are more consistent as you'll find out as you use the program.

Now, we now have gotten in this area and what we're going to do now is move one. Now, before we move on, there's one thing I want to mention we'll come back to later. Supposing you're analyzing this business and the profit was $100,000, can you come back later and adjust it later? Yes, we can, and we'll show you how we do it. It's very simple. In fact, you're going to find one of the benefits of working with weighted business values is everytime you want to make a change because the seller or the buyer or something has changed either small or materially, by just changing one thing and multiplying the adjustment times the weighted value and either subtracting or adding to the price, you find out what the new value is, and you're going to find in every case the system is set up so that you can make an adjustment or change in the program in less than a minute. That's how easy it is.

What I'd like now is you're going to be turning to the other side of the sheet and what we're going to be doing is getting involved in a thing called hard value assets. Now, as we continue on now with M Manufacturing, I'd like to restate something we talked about in the other tapes, and I haven't talked about yet on this one.

That is when you're going through this, try to clear your mind of all the other sections. Although we're going through Profit and Loss and Balance Sheet again, the thing I want you to realize – we're going to cover it in enough detail for you. What I'd like you to do as you go through each section, just try to concentrate on the section you're working on and try not to think how it applies to anything else.

Later, as we get through the program, we'll tie everything together for you, but if you want to make your educational experience a lot better and make it a lot easier, just try to take each section, learning that section as you go through it and then later we'll tie everything together for you and make it better.

Now, we're now going to be going as we said into the area that we said has to do with the intangibles, the goodwill, the blue sky, and again, these are all interchangeable terms. They all mean the same thing. What I'd like you to do is start to get your areas set up for the analysis, and I'm going to have you flip over the sheets because we've already gone through the Profit and Loss and Balance Sheet, and I'd like you to take the Profit and Loss which is 5-3 and turn it over. We're looking at 5-4, and you'll be looking at the Business Opportunity Owner Summary Statement. Again, this is a summary of information that we have for you. Then, on M Manufacturing on 5-5, you'll flip that over and you'll find a thing called Business Analysis Sheet.

On both these sheets, we have information that's going to be required for us to be able to go through and analyze this business to find out what the value is, to find the value of the intangibles and the goodwill, blue sky. One thing I want you to keep in mind as you look at these two sheets, and that is that this information is provided by us in this example, and as you go out in the future to value a business, this is information that you're going to have to gather from the seller of the business or if you happen to be the seller of the business, this is the information that you're going to have to put together as you analyze the value of the company.

Now, once you have this and you have turned over page 5-9, you're looking at the backside which is 5-10. It says, Hamel Business Value on the top. You have three sheets in front of you which I think is fine.

Now, what I'd like you to do now is since you're on 5-10, if you look straight across from 5-10 in the book, there is a thing called sheet 5-11. Now, what we have done here on this sheet on 5-11, I have listed the different categories that we're about to go through.

Now, before we go through that, I'd also like you to flip one more page and look at the back of 5-10 and 5-11, just flip over to 5-13, and what it says is pricing a business with Hamel weighted business values. What it's saying here, "its purpose is to establish a first step to set a standard for pricing businesses, and to provide our associates with a tool to help explain to others the details of the value." You have to realize one of the things we haven't even discussed yet is a system like this enables all parties of the transaction to explain not only what the value of the business is but how it's arrived at, and what each one of the segments the value is worth.

Now, caution what we're trying to tell you is no one is authorized to make copies of this program, and this is intended for the use of other Hamel business seminar students or people also buying our tape programs. You're forbidden by law to copy this program for any other person or company. We do check this and we strictly enforce it. Why? We spend thousands of dollars developing it, and we don't mind you using it. We just don't want you using it against us.

Now, this pricing system is set up to be the next step forward from the pricing of business using multipliers based on sales, and multiplies – as we've already said – based on that profit.

Now, you're going to find the staff at our office has been using this system to assist former students of our program since 1978. It was first publicly announced at the Certified Business Counselors meeting in Tampa, Florida in January '79. It's been tested continually and only implemented in May 1980. In other words, we checked this out in thousands of businesses before we actually put it in, and you're going to find as we've gone along, we've checked it out continually since then. Why? To find out flaws and find out different problems.

Incidentally, over the years, the main thing that we really have found that we have made mistakes on have been grammar, punctuation and spelling. I'm sure it will continue on.

Over the past two years, many bugs have been worked out in this new pricing system. Unfortunately, many still remain. We felt with your help and with your suggestions for improvement, we should be able to work out most of the small problems and what we're saying to you as you go through things and you're finding things that maybe have changed that don't fit. If you get back to us at our central office, you will find that we will make the changes and we'll get back with you with the changes.

Warning, this pricing system is not a panacea of the living end of pricing problems. We're not intending to replace the valuable job done by the professional business appraisers. What we're attempting to do is simplify pricing. We're only attempting to set standards of prices for business in the country. Please keep mind these are standards against which each of you can measure a business.

Over the years, as we educate more and more people, we hope to bring more business prices closer to standard as we're hoping to establish, and again, we have corrected a couple of them as I have mentioned.

So, remember use this as one of your tools, but don't get hung up on an exact price, and just use it as a guide. If you find a business that completely falls outside the range of our program, you may have to come back and let us assist you.

Now, what I'd like you to do now is turn back to the pages we were just talking about, and in front of you, you should have pages 5-4, 5-6 and also in your books you should be turning to page 5-10 and 5-11. That's what we're looking at right now.

Now, the back of the pricing sheet that we were talking about prior tape, is on page 5-9. This is the back side and we're going to be covering a thing called the weight business value, the value of the goodwill, the value of the blue sky. We're going to be going through 25 different categories.

Now, years ago when we first set this program up, and I told you we announced this in Florida at one of our national meetings, the thing you have to realize is I had a program and I had 25 categories, and the problem I had was many of the categories had 30, 40, and 50 sub-paragraphs which means it would take you somewhere between one year and two years to price or value a business. Was it accurate? Fantastic.

As a matter of fact, as we analyze this, the thing we realized is we had a program that was very accurate but how do you teach it to somebody? How do you show somebody else how to use it? You have to use computers.

Finally, somebody came to me within a couple of weeks after the meeting that we had back in Florida a number of years ago and said, "Hamel you're a typical engineer. You've over engineered it. Why don't you broaden the parameters? Why don't you lower the number of areas, categories that you have in each one and you'll have a better system?" I said, "Ah, it'll never work. That won't be accurate."

Now, it did sort of spark me, and what I did is I went back and checked, went back and modified it and tried it, and I hate to tell you this, the person who mentioned this to me was correct. As we went back and analyzed it, we found that unless you took the price, the four decimal points, you didn't need the accuracy that I had built-in in the beginning, because unless you wanted to price it to $500,000.43 and so many tenths of a cent in mills, we really didn't need the accuracy.

As we've done this we've found that it is very accurate without having all the categories. I want you to realize that all of the equations we did develop in this area were straight line equations, straight line functions. So, if you want to do a thing and interpolate, which means take a point halfway or a quarterway between the points, feel free to do it.

As we start to go through this area, the other thing we ended up with is at the end, we ended up with 25 basic equations because we were measuring 25 categories as you can see on 5-11. Number one, percent of the business the owner will finance. The answer's straight on that – the payment period.

In fact, the first nine categories as you're going to find out are financing categories. So, once you get through the financing analysis of a business, you're going to find you've taken care of nine of the 25 we're about to go through which is not too bad at all.

Now, as you start to realize we had 25 equations. We sat down, and although the equations were very accurate what we had was equation one said we had four apples. Equation two said we had two tangerines. Equation three said we had four grapefruits. The problem is by the time I had finished all 25, I really didn't have an accurate measurement, and I didn't have apples or oranges. What I had was a fruit salad, which means I really didn't have anything.

So, what we had to do was sit down and use a system or a thing called weighted values, and relate everything back to the same thing so that we could actually add one to two to three. In doing this, you have to realize we had assume zero points. We call them anchor points, but what ever you want to call them, you have to realize one thing. as you go through these and see certain values to be "00" or ".00", it doesn't mean that they are zero, or they're nothings. What it means is they are zero in relation to the total system. So, keep that in mind. It's zero in relation to the total system because we had to assume or start at some point and assume that to be zero.

If you can start with number one right now, what you're going to find is we would like you to go through these and as you look at number one and find out how much owner financing you have, what we'd like you to do is in addition as you look at 5-10 not only circle what the value happens to be – in this case .41 – but, also right information down as to how you arrived at this.

Now, the reason we have this comment area or the information area where we right down how we arrived at this, many times when we're evaluating a business to find out how much it's worth, in fact everytime, you're going to find a lot of these values will change as you go into deeper analysis or people change their mind on different things in the transaction.

You're going to find that the value of the business will change. So, what you have to do is please write down how you arrived at it, and do it in pencil, and that way when you come back later and want to make a change, you can erase it and put in the new information as to how you arrived at it. If you don't write the information on this sheet, and you're working on ten or 15 businesses at one time, you may have to go through a stack of papers two or three feet high to try to figure out how you arrived at that one item of price. So, please, under comment do write down how you arrived at it.

Now, what I'd like you to do now to see how good you are at balancing things. I'd like you to take page 5-4 and 5-6 and move them up in front of you, and what I'd like you to do is I'd like you to pull out 5-10 out of your book.

Now, there's nothing wrong with going back to refer to 5-11 if you'd like. In fact, if you'd like at this time, maybe it would be also good to pull out 5-11. Please then, close your book. If you don't do that, you're going to have so many pages all over the floor, you're not going to get back to where we started.

Now, in front of you now you should have page 5-4, 5-6, 5-10 and 5-11. What I'd like you to do now in your book after you've closed the rings, I'd like you to flip the page and look at 5-15. So, in front of you, you're looking at five different sheets of paper as a guide.

Now, what we're going to be doing now is we're going to be going to the different weight values to arrive at the price of what? Of the intangibles, the goodwill, the blue sky, and what you're going to have to do now is get to these sheets to dig out the information. In the future, you’re going to be digging it out by talking to the seller or going through certain documents.

Now, first of all, the financing categories. We have the first nine categories of the 25 are financing categories, and of the nine categories that are financing, we have the three subcategories because there’s only three basic financing categories that you’re going to run into.

Now, in this program, as you get to the section on financing, you’ll find later in the program that we have broken financing into three sections, but we also have a supplemental section. So, let’s talk about the three main ones right now.

Number one, the first category is owner financing. In other words, the owner is providing financing. The buyer puts down so much when they buy it, and the owner finances a certain amount of that company.

Our next type of financing is supplier and vendor, and again, these are the people that you are supplying goods to or services or people are supplying to you. These are associates of yours when you’re in business – suppliers and vendors – and they provide financing.

The third category is the one called institutional financing. In other words, you’re going to an institution. You may be going to a bank or savings and loan or the federal government and the Small Business Administration. This is institutional financing.

Those are the first nine.

Let’s start now and start going through this, and again, as you go through the first nine you’re going to start to get a feeling as to how this works, and you’ll find by the time you get to maybe ten or eleven, you’re going to start to get a feel for what we’re really doing here, so be patient with yourself.

Number one, what is the percent of the total business that the owner will finance? Because what we’re looking for is 100 percent financing, or as much as we can get. So, the first thing is how much will the owner finance? And, you’re going to find as you go around the country, this has been the standard for the last few years, most owners want 25 percent down on a business that makes between $50,000 and $500,000, and most owners will then finance the other 75. With the other 75 percent, they'll finance it and they'll let you pay off that 75 percent out of the business. So, what are we concentrating now? We're trying to get that 75 percent financing down pat, and keep in mind one thing – why would financing give a business value?

Well, think about it. Which would you rather buy – a business where the owner wants all cash and you have to go out to a bank and borrow at very high rates, which reduces your cash flow, or an owner where an owner's going to provide you with much better financing, longer term financing, and also in most cases at a lower interest rate? What does that do? It improves your cash flow, and also you're going to find it will do what? It will increase the value of your business. So, financing is a big part of the value of a business, and you should consider that first because that's the key to success whether you're buying it or selling it.

For those of you analyzing this from a selling standpoint, the more financing you provide, the more money you can get for your business. You're also going to find the better terms that a buyer gets in buying a business, the lower the failure rate because if the seller puts a noose on the neck of the buyer when the buy it and make the financing so tight that they have a noose that's very tight, no light at the end of the tunnel, when something happens, those buyers will walk. They'll walk away.

If you give the buyer breathing room, and even though the noose does tighten once in a while, the average buyer will not walk away. In most cases, we find that the reason the transaction doesn't work and the buyer fails is the buyer didn't have any breathing room. So, give the buyer some breathing room in the transaction. Structure it so makes sense. If it doesn't make sense, move on to something else.

Now, first of all, we're going to be talking about the owner financing, the first category. What is the percent of the total business the owner will finance? And, what I'd like you to do now is turn to page or look at page 5-6 which should be right in front of you, and if you come down on the right hand side of the sheet about eight inches it says, “Owner”. It says, “Sell, yes” and it says, “Terms”, and it says, “25 percent down, ten years ten percent.” You say, “My gosh what does that mean?” Well, this is shorthand that’s used in the industry and you’re going to have to learn in this program, and you should learn it by the time you finish these tapes.

First of all, what we’re saying is the owner wants 25 percent down. That’s a standard. You’re going to find then that it also said that the owner will finance for ten years at ten percent interest. It’s just shorthand. Okay, 25 percent down, ten years, ten percent. Where do you get the rest of the money? We’ll get into that later.

Now, the percent of the total business that the owner will finance and if you come down the sheet to percentage where it says 75, 61-80. So, 75 percent financing against the weighted value of how much? .41. What you’re going to find when we finish, we have given you the answers mathematically. When you finish all you’re going to have to do is add these 25 together, multiply it by a thing called the adjusted net profit, and you have what? The value of the intangibles. You have the value of the goodwill. You didn’t have to throw a dart at the wall. You didn’t have to do anything magic. You didn’t have to guess. You’re going to know mathematically what the value of what? The goodwill is, the value of the cash flow.

Now, .41 – so, on line one of 5-10, you would circle .41, and write down the information, order financing – 75 percent, ten years, ten percent. Then we can remember later.

Now, the next thing is number two – what is the interest rate on the owner financing? That’s difficult. What’s the interest rate? I’ve already told you, ten percent.

Now, ten percent, which comes to .00, it’s one of our anchor points. It doesn’t mean it’s zero. It means it zero in relation to the total system. So, on line two you circle 00 and again it’s the interest rate of what? Ten percent.

A lot of you that have not been involved in business or involved in larger transactions, probably do not realize, and we’re going to cover this in detail alter, that in financing a ten percent interest rate on owner financing is very high. In most years, you’re going to find that the interest rate on owner financing runs seven or eight percent, and you’re going to find even in the last few years when we had very high interest rates and the prime was up very high, most owners were financing at nine or ten percent.

Now, don’t come back to me and start talking about the imputed interest rate that IRS has in here because I’m trying to tell you what the real world is of what’s happening out there, and if you’re talking to a seller and a seller tells you that the going rate is 14 percent or 15 or whatever it happens to be, ask them a question, “Is that the going rate for 20 years on the financing, or ten years” What has the interest rate been over the last ten or 15 or 20 years? And, most sellers will laugh and say, “It’s been six, seven, eight.”

So, even when you’re paying seven or eight percent as a buyer, that’s not a bad interest rate over a long period of time. Even though the banks are going to make you think otherwise.

The next thing is the payment period of owner financing, and you’re going to see the owner tells us he will finance for ten years which is not a bad start, you’re going to find out many owners are going to start out and may want all cash. So, you’ve got them up to ten years. Again, we don’t give you a big star as ten years also because most of the people that go through our program, 80 some percent of them, get 15-20 year financing. Twelve to 14 percent of the graduates of our seminars, get 25-30 year financing. So, I just want to tell you from the Hamel standpoint, if you want to get ten year financing, you don’t even get a star. It’s not bad, but it’s only a beginning.

But, it’s not a bad start, because remember, we’re analyzing this business, and it’s basically we first talk to the seller. So, we have ten year financing. It’s a .35. So, we circle .35, and again, put down the appropriate information.

Now, suppose in a little while the owner says to you, “Hey I feel very good about you, buyer, and instead of financing for ten years, I’m going to finance 20.” You say, “Hey great. How do we change this?” Very simple, if ten years was .35 and you looked at the sheet, what is the value if the owner gives 20 years? .63.

Why would a business be worth that much more because the owner gives you 20 year financing? Well, I just want to tell you one basic thing. You’re going to find if you analyze the payments and the cash flow you have for ten year financing, you’re going to have this much. Again, a small amount of cash flow.

When you start to get the seller of a business up to the point where they will finance for 20 years, you’re going to find that the cash flow that you have left over becomes almost obscene, truly fantastic. It also makes it a lot easier to make it, and what we have built into here in equation three is two things.

Number one, what would the additional value of the business be if you have 20 year financing versus ten, and the second part of it is, what would the lowering of the failure rate be because wouldn’t you like to know mathematically what the failure rate is? And, what we’ve done is you don’t even have to think about it, we’ve built in for you mathematically, and you’re going to find the more breathing room that the person going in or the better financing you have, you’re going to find the lower the failure rate is. So, we built in the two things for you mathematically.

You’re going to find that after 20 years, it’s just sort of a psychological thing. You don’t pick up that much getting over 20 year financing. So far what have we gotten in the first three sections? We’ve analyzed and gotten values for that portion of the financing that has to do with owner financing, and you’re going to find the owner will finance 75 percent in most cases. Now, we’ll get into the financing later on other problems or aspects.

Now, once you’ve looked at category one through three, you’ve analyzed one of the main areas when you’re buying or selling a company. As we start to look at four, five and six, and if you just turn the page, you’re going to find we’re getting into category two, the second category which has to do with supplier and vendor financing – supplier and vendor financing.

Now, when you have supplier and vendor financing, what we basically have is we have the same type thing. We’re looking at the amount that they will finance. What is the interest rate? What is the payment period? Now, remember these are people that are supplying us with goods or services, and keep in mind in almost all cases, we are their customers. As we get into financing later, you're going to find that we're talking about borrowing cash from these people. This is not getting extended credit. This is not getting all the other benefits you get from your fellow business owners. This is cash. Cash we're going to be using to buy this business or for working capital, but basically to buy the business.

Now, in this case right here I want you to realize this M Manufacturing Company happens to be a real company. In fact, in all of our programs, there's only one example we've ever used in all the programs we've ever taught that were not businesses we owned or have owned, and if you'll recall the only one that we have in this program is the one that we had in the section on the Profit and Loss, and the reason that we don't use our own, that business as you'll recall is the one that is fraudulent and we don't like to use companies of ours that are violating the tax laws. That would not be very smart.

Okay, now the percent of the total business the supplier will finance. You're going to find in this case, we're able to get the rest of the financing from the supplier and vendor. Now, don't start to muddle your mind right now whether you can get this financing or now. We'll talk about that and hopefully we can convince and show you how to do this later in the program, but right now I just want you to concentrate on the fact that this happens to be a real example, and I can reassure you that we got 25 percent and we borrowed it from the suppliers and vendors. We got 75 percent of the financing from the owner. We borrowed the other 25 percent from the suppliers and vendors.

Now, supposing I had to use my own money. Supposing I went through one, two and three, got owner financing, and on the other 25 percent, I had to use my own. Well, if you do that, you have made because on four, five, six, seven, eight and nine, it's not applicable. You just take four, five, six, seven, eight and nine and don't fill those out. Why? Because the only financing available is what? One, two and three. The same thing happens if you solved your financing problems in six of the nine. You leave the other three blank.

Now, this example here, we've gotten all of our other financing from our suppliers and vendors, and it comes to 25 percent. So, what is the weighted value here? .43 which you enter on your sheet.

Number five, the interest rate on supplier financing – the thing I want you to realize, the average interest rate in the United States when a supplier lends you money is zero. Now, when I tell you zero you have to realize there's no free lunch, but you have to realize that although they may be lending you money today, in the future if you're going to be the owner of the business, somebody's going to come to you and borrow money, and we do a lot of lending back and forth whether it's extended credit, which means letting somebody paying 30, 60, 90 days out or lending them cash. It's done quite often. It's the largest area of financing in the business community. That's where the money really comes from. The thing you have to realize is if we started charging each other interest in business, we'd put each other out of business. We're not bankers. We're just trying to keep each of us alive.

Again, I want to keep myself alive in business, and if you're working with me supplying me with goods or I'm supplying you, I want to keep you alive too. Why? I have an ulterior motive. You keep me good no matter which side you're working on, and if you need money and I have it, I'm' probably going to provide it.

Now, on the percent of total business – we talked about the 25 percent. As we get to the interest rate, in this example here it happens to be zero a .21. Now, the thing you have to realize is there's a little start or asterisk the zero percent interest or the .21, and if you look at the foot note it says, "If zero percent is used, do not use category six, the payment period."

Now, why do we have that here? Because the standard in the United States is and has been, we do not pay interest on this. I want you to be able to go back to this tape program over and over again and everytime you look at number five, Hamel is telling you, "Don't embarrass me by paying interest." Do you hear what I'm saying?

Now, I want you to understand though, if you go out to the community and you find that you run into a supplier, it's you're only source, and the person wants eight or nine percent interest, and the bank is charging 15, pay it. That's fine, but I want you to realize that the standard is zero, but don't blow the whole deal. I mean, just don't' blow it because they're going to charge you interest. Try to talk them out of it. Try to get somebody else to do it, but if push comes to shove and it's a lot less expensive than anything else, do it. Quit thinking about it.

So, what we have here is a weight value of .21, and as I said, anytime you have zero interest, what do we with number six? We eliminate it and we don't use it, and you'll see that number six we just basically crossed through that number.

Now, in this example, we've already gotten the financing that we need. So, if you're looking at seven, eight and nine, you're going to find we're not going to be using it. Let's talk about it anyway because supposing you go through this and you find you do need institutional financing – SBA, bank, whatever – you are going to use seven eight and nine, and they're the same as the other six categories we just went through.

The first one is a percent that the institution will finance, nice and simple. Now, the next one, number eight is not going to be that sample, and although it's not in this example, let me talk to you about it because it's the interest rate on institutional financing.

Now, what we're saying here is on the first 40 percent of business value, if you're buying from the institution and it represents 40 percent of the business value, these are what the numbers are.

Now, when you start to get up to prime plus three and prime plus five, I Hamel, your friend, are telling you everytime – if you get involved in prime plus three and prime plus five loans, I am predicting mathematically or we are, that you are going to go out of business.

Now, on up to 40 percent, you'll see the weighted value is -.50 or -1.0. I want you to realize that mathematically within this, we're pricing the value of the business. I also want to tell you that if in any one category, any one value comes up to -.50 or greater on the minus side, we are telling you and recommending mathematically do not buy that business unless you can correct that problem. Okay, because even though you may have a price on it, what you have here mathematically, what we're telling you mathematically, is you have a flaw in the business, and this flaw is going to sink you.

Again, it could be -.48, anything in the range of -.5, and anything above that, the further above it it goes, the more we're telling you you're going to fail. So, you have prime plus three and prime plus five and I can tell you all sorts of horror stories that happened in the 80s when the prime went up over 20 percent, and that means that you end up paying 25,26, 28 percent interest.

Do you realize on these also, that they want your house as security? They want to cross collateralize which means they want your house and every other item you own? That means they take everything and use it as security. Do you know what these loans are for? These loans are for dummies. These are loans that banks or lending institutions make even though the thing doesn't make sense. In other words you want to buy a business. The business doesn't make sense. If you want to borrow $100,000 and put a million dollars in security, the bank will say fine. They don't give a darn. Why? Because when you fail they end up making even m ore profit. So these are dummy loan. If you want to get a dummy loan get it, but I just want to tell you something. I am predicting not only based on the mathematics but my personal experience, that you're going to fail because what we're seeing is these are normally five year loans and in a five year period, the way the country's running today at least once for a short or long period of time the prime will go up over 20, and when it does, your ship will sink.

Now, that's only part of the bad news. If you go down to section B, when you're going out and getting this institutional financing of prime plus three and prime plus five, on 41 percent or more of the business, how do you like those numbers? -3.7, -3.2, in fact, with just these two numbers on every business almost every business you run into, it will wipe out all the other values that you come up with. Has a great management team – this wipes it all out, and you'll end up with a zero or a negative number. What does that mean? You can't do it. You shouldn't do it.

I want to tell you something, I would say that a thousand percent of the time you're going to fail, but when you get up in this level here, you are up in the major failure area. In other words, your chances of making it is remote, almost none. I can almost say on this one it is none. You're not going to make it, and those of you that don't listen, again, I'm not doing this form a textbook, I'm doing this from experience. I've been in this business over 30 years. I've seen people like you do it wrong. I've done it wrong myself with tears in my eyes. Please no prime plus three, no prime plus five. Figure out someway to do it.

It's not worth failing, and again, if you don't believe it go down to bankruptcy court any time during the week, and you'll see people that didn't listen in these areas. You can't make it the numbers don't work.

The last area, payment period, again, is the same as you had in the other categories.

Now, as we start to go to the next one, number ten, on page 5-18, you're going to start now to get a feel for how this work because this is a little more general in the financing, and what you're going to find as you start to go through the rest of the categories, you're going to find the things that actually make up the value of the business. You're also going to find the things that make a business easier to run, difficult to run, to make it fail, or live that good life. You're going to live in that big boat down in the South Pacific, and it's going to start to boil down to this.

Now, as we start to get into number ten, you're going to find out the next categories, three of these categories ten and a couple of them after that, are actually going to be categories of things that measure value of the business that are actually outside influences. Things that are going to be outside influences that are going to determine how much money you're going to make, how much profit, how many sales, and how easy your life's going to be, and these are good conditions also.

Now, type of market. We talk about the type of market. If you're looking at 5-11 also, it says type of market, where? In the industry – type of market in the industry, and what we're looking for here is we're looking for something pretty good.

Now if you look at your sheet to find out what your company has, you're going to find the type of market within the industry, and it says, 'Type of Industry – Manufacturing', and it says above that on page 5-6 on the left side of the sheet about two inches from the bottom under industry, it says, "Level of market within the industry". So, what we have here is a flat level of a market, and if you want to think of yourself as sort of floating down a business stream. You're in your little business boat, and you're floating down this stream. If you have a flat level market, you're going to find that the stream or the market within the industry is going to have not too much of an influence. You and your management can work a normal number of hours, and your profit and sales will stay sort of flat and level based on that one area.

Now, looking at number ten, you're also going to find that we have an expanding growing market. If you happen to have an expanding growing market, you're going to find that just by going down that nice business stream with your management, and working very few hours, you're going to find the industry or the market is going to do what? It's going to drag you up with it, and you're going to find you and your average management will be able to sit there, work a normal number of hours, and the industry itself will do what? Drag up your sales and drag up your profit. That's a nice business to be in.

The worse category is a thing called declining marketing within industry, and what you're going to find it has a minus number, -.29, and the reason it does is the fact that a business like that when you're floating down that business stream, you're going to find that you have to work 70-80 hours a week to do what? To overcome the declining market, and what you're going to find is those are the businesses that cause you a lot of problems. Why? Because although you're running like crazy, you're running a board with grease on it. What you're going to do is the faster you run the more you slide backwards. So, if you find a declining market within the industry. I'd say beware. In addition to pricing it, be aware of the business you're in.

The age of the industry – the next thing we have here is the age of the industry because basically new industries are get rich quick areas, and very risky. Again, no matter where you go people are trying to get rich quick. Nobody wants to take their time. As you know in our programs our motto, and the way we operate is, become wealthy slowly. As we try to convince all of you over and over again is you can make more money in business honestly than you can dishonestly, and also if you take your time and dot the "I's" and cross the "T's" you don't have to experience failure. What'll happen is you'll succeed everytime.

Now, we start to think about these industries, what kind of industry do we have here. Number one, we have an industry that's manufacturing, and again what's the age of the industry? It's over 20 years, and as you look at this, the age of industry, it's an old industry established over five. So, this industry qualifies as +.27 which I think is really fantastic, and what happens is the industry has settled down. Although we find in the United States that the failure rate in start-up business is very high, and maybe the overall chance of making it over a four or five year period is only one in ten, the thing you have to realize when you also additionally get into a new industry, you're going to find that number one your average chance of making it is one in ten, and a lot of new industries, your chance of making it in that industry is one in 400 and one in 500.

So, if you take the one in ten and multiply it by the one in 500, your chance of making it – well, you have more chance of flying to the moon this afternoon. So, what I'm saying is beware of the new industries. Let them settle down. This Horatio Alder stories about the first one in the area, the one that's going to get rich – no. Just like franchising. What I want you to do is be the first one to go into that business after somebody else does it successfully. Let the other people screw up. And, after they've screwed it and gone down the tubes, then you go in and do it.

New industries – we're talking about in the formative stage – in the first two years. Again, just don't hold that to two years because you have industries that still haven't make it. Solar has been around longer than two years and we still have a high failure rate. It's still in the new area. Why? The state of the art of the equipment is really not very good, and it's still in a new area. So, you have to look at this and use your common sense. In other words, forget about the two years. It's still new because some things are going to be new ten years from now.

Another industry that's been around a while or a business – video discs. If you don't believe video discs have been a problem, why don't you contact RCA, and you're going to find that they've had trouble. The video disc business really hasn't done very well. Again, video tape is taking off like crazy. Video discs, you have a basic problem – number one, you don't have a lot of inventory. Number two, you have incompatible systems, and you also have a company that has a tape they're working on right now – in fact, they have it out on the market – that actually is erasable, erasable disc. So, what you're going to find is the state of the art – stay away from those.

What I want you to do is go out and get involved in businesses that are middle of the road, that are doing very well know. Look at those nice businesses that are start-up – buy one now and then four or five years from now, go out the ones that have settled down. How do you find out? Right now there will be 500 in your area in that business. Get a list of all of them. Five years from now, call them, all of them will have disconnected phone except three or four. When they answer and say, "Hi, there. This is ABC Solar." Say, "Hi, would you like to sell?" What you'll find is a certain percentage of them 20-25 percent of them will want to sell, and what you're doing then is you're buying into something after the risk is gone.

I keep telling you, if you want to do something risky, go skydiving, buy a racing car, but in business, stay away from the risky areas. Always protect your cash flow. It makes like a lot better. So, what do we have here? We have an old industry established over five years.

The next thing we have and we're going to discuss number 12, is the competition in the industry because what you're going to find is although a lot of you – I'm going to think of you as macho or you're going to be called machoist, a woman, I have no idea –

the competition, and what we're trying to do is get you involved in businesses that don't have the competition.

Now, what I'd like you to do is look at the sheet you have here, and look for the area called competition, and under industries it says competition in the industry, it says none. Now, as you go through this I'm now going to start to show little things that are different from what we have on the form here, and what happens is I wrote down what the owner told me in the beginning. The owner of the manufacturing company said I had no competition, nothing, none. So, what you do is race back and say, "No competition." Ah, they were using the wrong terminology, and let me give you the basic thing you're going to run into that's going to give you a little difficulty, and that is the psychology or make-up of different business owners.

When you get involved in a manufacturing company, you're going to find the man or woman that owns that company is going to be sort of laid back compared to the other extreme like retail, and when you go into work for the people that are in manufacturing, they're going to say, "Hey, no competition." That doesn't mean they have no competition. That means that they are laid back people, and competition is a normal part of the business. The only time that you truly have no competition from a measurement standpoint which is what we have in number 12 is when they have a lock on the market, a definite lock. So, don't be followed by the terminology they're using especially with manufacturing.

What you're going to find in this example, although they say no, you're going to find it's really average competition. It's your average business which really doesn't have much competition, but it doesn't have a lock on the market. It's +.09.

I also want you to realize going in the other extreme, we have a thing called highly competitive, very cut throat, clothing manufacturing, a -.93. You're going to say, "Why would I want to go into that?" Well, unless you've been in clothing manufacturing, and you have been successful, I want to tell you something. You shouldn't consider it. Even if you have been in it before, I'd suggest you try something else because you can make more money and you can do it consistently and have a nicer life.

Now, when you get involved in the area of highly competitive, you're going to say, "This has to be retail clothing." No, it doesn't, but when you do go out to talk to an owner of a retail clothing business, and I'm only comparing types of people, you're going to find that compared to the average person who owns a manufacturing company, they are not laid back. The average retail person, especially in clothing, is hyper. You're going to find they'll say, "Oh, gosh, I've got lots and lots of competition driving me nuts." When you go out and check you're going to find they're in the same position. They have average competition.

Now, the reason a lot of you are fooled is the fact that you'll go to a regional mall, and you'll see 28 women's clothing stores, and the owner will say he's got so much competition it's driving him nuts, and you'll believe him. What you don't realize is the average mall has 26 women's clothing stores. They may have 28 when they start, but after a year or two, two weak ones will fall out, and you'll have 26, and that becomes what? Average competition. You say, "Well, there's a lot of them." Let me tell you – the malls have the same thing we used to have years ago in the downtown areas. Women liked to go to clothing stores, 25 or 26 of them, and not spend any money - the same thing with shoe stores.

Now, when we talk about medium competition, we're also talking about something you can come up with which is restaurants. You all think that restaurants is a lot of competition. It really isn't so, and you're going to find that the only time you have above average competition in the restaurant business is when they put too many in an area, and the reason you have this quite often in the restaurant area where there had been an overbuilding is because everyone thinks they can run a restaurant and that's not true.

One last thing I want to mention on this highly competitive, and I'm talking about very cut throat. When I'm talking about clothing manufacturing, I'm talking about clothing manufacturing that changes its styles four times a year. It has to go from design to financing, to manufacturer, to shipping, to selling in a three month period. How would you like to be in an automobile assembly plant and have to change your model design four times a year and also finance it four times a year? And, that's where the difficulty is that we have right here. What you have to realize is, my example is if you're in the clothing business, fine, but if you're not in the clothing business the thing I want you to realize is you don't want to have a business next to the clothing business. Why? They probably have one of the highest burn rates in the country. If it's a good year, fine. If it's a bad year, you're going to find they have a lot of fires. My rule is unless we have a 20 hour firewall, I don't want to be next to one.

Again, for those of you that want to live in Beverly Hills and live in a big mansion, you'll be able to do it in that type business, but also you're going to find that's one year. The next year you're going to be pumping gas like a Hollywood rock star in downtown Hollywood.

So, what I'm trying to tell you is why not stay in the areas where you have steady growth? Go after the ones that you don't have that competition. Why make life tougher than it already is? Go after average competition.

One of the other areas, we talked already about three basic areas that are outside the business that influence your way to make a profit, the ease of making a profit in sales. One of them had to do with number ten which is the market and industry.

The next one is the local economy, and what we have here local economy is another outside influence, and as you're floating down your business stream, you have to realize that what we're looking for is the best which would be a dynamic local economy. If you happen to look at your sheet on again 5-6 on the left side up about three inches, it says, "Economy." Again, it's going to be owner feeling in the beginning. Later, as you start to check it out, you're going to be able to find it out on your own because let's face it a lot of times owners are going to embellish. You can call it lying. What they're doing is they're basically doing some creative selling, and as you start to check it out you may find that it's not that accurate.

So, under the economy, you're going to find local. It's strong, very good. So, what we have here is a dynamic local economy, and as you and your average manager are floating down this business stream, you're going to find that the local economy being very strong and dynamic is going to do what? It's going to have a tendency without you working a lot of hours and killing yourself and putting out a lot of effort, it's going to pick up your sales, pick up the profit and increase it.

Now, on the other hand, if you happen to have a stable local economy, you're going to find the things have leveled off, and we have a value point of .00, but the main thing is you're going to work the normal of hours and the profit and sales really aren't going to do much. You have to be weary of that. When the inflation rate is very low, it's not a problem, but you're going to find if the inflation rate gets higher again – it gets up to five or ten percent again – you're going to have to realize that this business, if you have inflation and have you a stable local economy, you may have to work more hours to do what? Not to overcome the economy, but to overcome the affects of inflation.

The worse condition would be a declining local economy, and that's when the economy is turning down as it has for some time, the downtown area, and what happens is you and your average manager floating down this income stream are going to find that the businesses are going to slide unless you work a lot of hours. So, you work 50 or 60 hours and you're going to find that you're basically level. You find if you work 80 or 90 hours, you may be able to even increase it. But, the thing is you're going to find it makes it very difficult.

Now, the thing I want you to realize is be careful in this area. If you're talking about the economy, and you're in manufacturing in Southern Florida, and you're selling to northern Maine or northern Washington, I want you to realize you have to analyze which market? The market you're selling to because that's the economy no matter where you happen to be located.

I also want you to realize because a lot of you make mistakes in this area that if you're in a city or in a county, and say the county has a reputation like Orange County, California for fantastic growth, but you may be in a retail business in a downtown decaying area, you have to measure the area you're in and the area you're serving. In other words, use your common sense.

In the next section, another outside influence of the three is the nation economy, and the national economy does influence your ability to generate the maximum profit. It's basically psychological. If you remember back to early 1980, we were having runaway inflation. We also had people spending too much, and the government tried to cut this back under the Carter Administration, and what the government ended up doing is actually putting limits on the amount you could borrow. The cut back limits on the credit cards trying to cut down on this wild spending that we were doing in this country. And what happened is as soon as the media starting telling it, it was media induced. The media came back and told us that things were not going well and we were coming into a recession, and within a few months we started to believe that.

Incidentally, the thing you have to realize when you're in business, you have to beware of reading of the business page when they start to tell you this because psychologically, you'll start to back off. I find in business myself, as soon as I have a recession, I don't read the paper anymore, or that section. I read the comic page which is probably the business page also.

But, the thing is what we do in this area then is we go ahead because you're going to find the easiest time to expand is normally during a recession. Why? Because everybody else psychologically and directly have backed off.

Now, right now we needed a point in time because this happens to be an example that we had to fill out. We had to assume a level at the level this was made, we had a level economy which gave us a .00. If you happen to be at a time right now when you're listening to this tape and you're in a recession, you're going to have to use the recession number, and hopefully you're going to be in a period which our country enjoys most of the time which is a growing economy which is .12, but, at this time in this example using .00.

It doesn't have a lot of influence, but it does have an influence to the extent that is media induced and the public is told that things aren't good and they don't buy. Again, when the media then starts to come back and the government tells us things are good again, you're going to find that your business is going to do a lot better generally.

The next category- and one a lot of people don't think about is one that drives a lot of people crazy and it's turnover employees because generally the greater the turnover the business, the more difficult it is to train, retrain and to effectively manage their employees, and what we have in this example right here if you want to find out what the turnover is, if you just again go to 5-6 left-side up about five or six inches. Under employees, it says Turnover-once a year. What it means is looking at our sheet on 5-20, the average employee is on board how many years? One to three years, it's a point .00. That's not bad.

Here's an example here – Hamel's T-Shirts. You come into Hamel's T-Shirts and you're going to find we have a heck of a lot of turnover. In fact, we'll open at nine o'clock in the mall in the morning, we'll close five or six o'clock at night. I have so much turnover that when I open at nine o'clock in the morning, I will go into the business T-Shirts at ten o'clock with a handful of bills, talk to the employees and ask them, "Okay, you've all worked one hour. Who wants to work another hour and who wants to paid off and quit?" And, you'll find that every hour I'm hiring new people. In fact, our turnover is so bad in our T-Shirt shops, that by the time I hit five or six o'clock, if somebody has worked all day for that day I will give them a gold watch and we have a retirement dinner.

There's certain businesses that look for turnover, and you're going to find that a lot of the fast food chains will do this. In the large fast food chains especially in hamburgers actually hire people at minimum wage or a little above, and they will have benefit programs set-up, vacations, bonuses, raises, promotions that come up in about six months. You will find that they will have turnovers of 200-400 percent, and they enforce this because they have found it is easier to bring in new people and train them then to give you the bonuses and the benefits and the promotions and the vacations that you should have coming.

So, what they do is you start to hit your fifth month or fifth and a half month, if you're not a person moving up to assistant manager or one of the people they want to keep, what they're going to do is quit scheduling hours or only schedule an hour a week to force you to quit or they'll end up firing you.

So, they're looking for turnover in a lot of those businesses. That's how they keep their labor down.

The local labor market – this could affect your labor costs and ability to hire and keep employees. Now, the thing you want to keep in mind here is what kind of labor market do we have right here? And, the local labor market here says, "Good supply of help." And, what it means is looking at number 16, you have a good supply of help, it means what? Little competition for employees, so, it's a .00.

Now, the thing you have to worry about is a thing called strong competition because if you have strong competition for employees, you're going to find it's hard to keep people. You have to pay them more which takes away from the value of the business. It also gives you one more problem, and if you've been in business before you're going to find that one of the biggest problems you have and the number one problem are the employees because the people. Those are the things that really drive you crazy as the owner of a business or as a manager.

Now, the thing I want you to realize also in strong competition – supposing you happen to have a retail store and you're in a mall area. You're going to say, "Well gosh, we're paying them minimum wage and there's 18 percent unemployed. You're going to say, "There has to be a lot of people available." That's not going to be necessarily true because you're going to find a lot of times when you're in an area although there's a lot of unemployed, the average regional mall is in a middle class or upper middle class area, and these people do not like to work for minimum wage. What you're going to find is the average mall will need one, two, three thousand people to work there, and you're going to find that you end up going five or ten miles away to get people to come to work there.

If you have a mall location, I would advise you don't pay the minimum wage. You find out what the average wage is on the mall and you pay ten or 15 percent more. If you don't do that, your employees will go out on break at ten o'clock and not come back.

You then have to go out at ten thirty, and look for other employees strolling around the mall that you can hire. So, what I'm saying is pay a little more and cut down your overhead, cut down your turnover.

The next thing labor union – do we have a union here? Yes, we do. We have the Teamsters, and you're going to find the Teamsters – the competitors also have Teamsters which is okay.

Now, let me start to go through this now and see if I can do this properly. So, this is the only consideration that the company being considered has a union. Now, if you have the Teamsters, I think you're going to have to agree that their strong, but the competitors belong so it's a -.45. It's not exactly .50, but I'll tell you something. My belief is that you should have a business that gives you as few problems as possible. As soon as you start to have a union, although unions are something that's required in this country, I believe, you're going to have to realize that as soon as you have a union they take away a lot of the rights that you have for hiring, firing and running your company. You're going to find it's almost like working for somebody else.

You're also going to find unless you're the owner on premises running it all the time, the union people are going to do a better job of getting additional benefits than your management is going to do building up the company, and you're going to find the union employee costs as a percentage of total sales – the percentage will go up every year. You'll find that unless you increase your profits and do a good job, you're going to find that that extra money that they're getting is going to come out of your bottom line net, and eventually you're going to be running that company just to employ your people.

Now, as you know, the union thing goes back and forth. The pendulum swings back and forth. All I want to tell you is one thing – if you can find a business without a union, fine. That's one of the nicest things to own as you own your own company. But, if you're in an area where you have unions, then learn to live with it because as long as you have other people that also have unions that have to pay the same rate and have the same problems, then you can compete because you're in the same marketplace. You're in the same problem area. You can then compete effectively.

What you have to worry about is when you do have a union and your competitors don't, and I can tell you flat out your chance of making it, again, becomes little, remote and almost none. That's why we give you a -1.31. Again, a lot of you can argue it. Again, I'm not trying to put down unions. I'm just trying to tell you. You're going to have problems and you're going to have problems that take away from the value of that business, and if I had a choice, what I'd do is I'd try to stay away from unions. I'm too old now to have to sit down and fight the unions.

What I do want you to realize when you talk about the Teamsters, I was a member of the Teamsters years ago. I've been a member of many unions. When unions come to me and ask me why I seem to have an attitude that's anti-union, number one part of it is I represent management, and the other part of it is and I've mentioned this many times, my first union negotiation the windows were knocked out of my little Chevy after I got out of school. I was negotiating with little steel, and when I drove back to my little apartment at that time, many years ago, sitting on that broken glass with the wind and snow blowing into my face, I developed my union attitude that I have to this day.

The other union negotiation I got involved in, they tore the top off my convertible. So, I've had trouble with the unions. Again, I'd like to say something. My best friends are union members, but again all it is a thing – we have unions and we have management. As you're going to find as you go through this program or get to know me or us, that we believe in treating the employees fairly. I don't care whether they're union or not union. We, in this country have to get back to the point where we do a better job with the employees and make them part of the team.

Number of employees, number 18 – a large number of employees in relation to the net profit, the less valuable the business. More employees mean more problems usually in direct proportion to the number. That's stupid. If you think that's stupid, this next sentence is so dumb. How dumb is it? It is so dumb that when we put this in the beginning, we were hysterical with laughter. But, so many people complained about us taking it out, that we have put it back in. What the next sentence says is if you don't want to have many employee problems, don't buy a business with many employees. Can you imagine spending this much money for a tape program and having me say something as dumb as that? But, that's what it is. If you don't want have any employee problems, don't buy a business with a lot of employees because I want to tell you something, the more employees takes away from the value.

My ideal company, I've told my wife this many times, is a company run by robots. Everytime I tell my wife this, she says, "Hamel, if you ever get one, they probably will attack you."

In this business here, the number of employees we have is not unbearable. We have 15 which gives us +.07, but you're going to find the larger number of employees the more problems you have. As a matter of fact, before we discuss restaurants, one of the biggest problems with restaurants is not competition. It isn't because it's that difficult. The main problem you have is for the amount of profit you make in a business like a restaurant, you have many more people than you have in a lot of other business. I mean, there are many restaurants that make $50,000 net a year, and they have 50-80 employees. You'll find many businesses out there that make $50,000 that only have two. Which do I like? Two or none.

The next one type of management – we're talking about a basic problem that a lot of people overlook when they're getting involved in either selling or buying a business. As a matter of fact, most sellers lose sight of this and then they wonder why they end up taking back their business. One of the reasons they end up taking back the business from the buyer is the fact that they didn't set up the financing up right and they strangle the buyer.

The next big thing that we run into is the management problem that the seller leaves the buyer with which they can not solve. Let's go through this right now because let's look at the management of M Manufacturing.

First of all, right here – management available, again going to 5-6 left side up about four or five inches. It says, "Management available." It says there's a manager. The manager will stay and the manager's been on the job for seven years. So, let's analyze that. It says, “Managed by the manager”, and going to 5-22 on our pricing, it says, “The owner supervises the manager, and the manager’s been there over three.” Which is our example here, it’s a +.41. Even if the manager under three years because you have a manager is a +.27.

A lot of you listening to this tape right now that have not been involved in business, I’m sure no w are worried about the fact that when you go in to take over a company, you’re not going to have any manager. The manager’s going to leave. I just want to tell you something. While you’re listening to the tape, think about that fantasy because you’re going to find out in the real world it doesn’t happen very often. Small companies have as good management or better management than large companies have. Small companies have the best turnover than large companies in management. And, most small companies pay their management more than large companies.

You’re going to find in almost all areas what is real is the opposite of what you’ve read because it’s the propaganda of the big companies put out, and you’re going to find that small companies have better management, great people.

Now, supposing we get to the point where we have one owner, the manager, and he or she is leaving. It has value of only -.03. You say, “Well, that’s not too bad.” You have to realize when you only have one owner leaving or one manager leaving, you have one manager to replace, and you’re going to replace that person. What is the chance of you doing it yourself or replacing that manager or owner with one person, statistically? One chance in what? Yeah, make up whatever number you want. That’s not too bad. You can do that effectively – replace one manager, an owner, get a manager, do it yourself. You’re going to find you’re going to do well.

Where the problems come in and where the numbers become very negative if you look at your sheet, we have two owners and managers that are leaving, or two of your managers are leaving –whatever it is, one owner and one manager. What it is you have two people that are directly in management working full time and both leaving. I just want to say one thing, as soon as you start to get up to this level, you have a -.52 which is what we're telling you as soon as you go beyond one and you go up to two, your chance of making it is little and remote.

If you make the dumb mistake of buying a company or getting involved with a company where there's three people leaving in a smaller company, your chance of making becomes none. In fact, statistically, the failure rate approaches a start-up business somewhere between two people and three people leaving which means you've gained nothing. In fact, one of the biggest things you're buying when you buy a company – it isn't the cash flow – it's the continuity, and you're not going to have continuity of profit without the management people. You have to have them there. And what happens statistically, the chances of replacing one is one divided by so and so. Two is one divided by so and so times one over so and so. And, you're going to find that thing called the denominator, the thing below the line gets very large with two, and if you want to see a large number below the line get up to the three. In fact, in most cases when you get up to three, your chance of doing it is either one in 100,000 or one in a million. Think about that.

What I'm saying is if you're the seller, I would suggest that if you and your two partners have been running this company and there's not other management, that what you do is you start to phase out your different people. Start to bring in one or two managers. Work out a program over a year or two to build in management, and then sell it to a buyer, or stay long enough to crutch that buyer until you can be replaced. If you don't do that the seller loses because you the seller end up having to take the business back and losing your investment, in taking it back, probably down the tubes. You the buyer also end up losing also because you end up goofing up the company because you couldn't take care of that management problem, and you end up blaming yourself, and usually the financing and the management condition is something that is there when there's a change of management, a change of ownership and what you have to do is make sure it's as close to being what you want as possible. So, beware of too much of change of management because that's one of the key things you're buying in a company – cash flow and the thing that generates that cash flow is that management team you have.

The next category is ease of management, and we want to say there's a range of difficulty of management based on the amount of sales generated by direct effort of people. Since people are inconsistent or difficult to manage, and so people in intensive industries such as service are more difficult to manage. In an equipment intensive business, with fewer people it will be easier, and that's what we have in manufacturing, +.26. I'm sure those of you that own manufacturing companies think that your company is the toughest category to run. You just have never owned a service company because you're going to find that basically in a service company, you are earning all of your sales and profit by the direct effort of people. People are very inconsistent.

As you get into retail, you have inconsistent people and a semi-consistent product. It makes it a little easier. When you get to manufacturing, you have machines manufacturing even though people are running the machines, there's fewer people involved. You're going to find the management is a lot easier.

Again, it's not than any of it's easy. It's only easier comparing one to the other. That's all. So, we have manufacturing +.26.

Now, the years in operation – the national figures tell us the longer a business lasts, the better chance that it has for success, and what we have right here is – if you go back again to 5-6 – we want to find out how long this business has been around, not the industry we've already measured that, how long has the business been here. Twenty-two years, if you'll take 5-6 and go up to the left side of the sheet and go down about three inches, it says, "Years present owner – 10 years. Years established – 22." So, years in operation, over 20 years. You're going to say, "Well, gosh it's obviously has more than one owner." Let me tell you something, the longer the business has been around up to a point, the lower the failure rate, and the more owners because if this business has shown consistent growth through three or four owners over a 20 some year period that means that it's almost indestructible. In other words, no matter how bad the buyer is, you're probably going to have a hard time trying to destroy the business – not that they would. It's just that we're looking for the strongest transaction possible. We're looking for the best buyer and seller combination possible.

In this case, since we're talking about pricing a business, I want you to realize we're talking about the things that make up the value. We're looking for strength there. Looking for the good things.

The thing I also want to warn you on as you start to get down below five years, you're getting into the danger area. My rule has always been if it has been down around five years I won't even look at it because if it's been around under two years or under a year, why are they selling? Why would they be moving that business out again? How much value does that business really have? It's been around X number of months, and even though it's showing $100,000 for it's first year, is that going to be a good pattern? Are you buying it based on – I'd rather see a track record of at least five years. So, you're going to find that I like over five years. Why? The failure rate starts to go down quite fast as soon as you get up to the five year period, over five.

Now, the net profit, number 22 – this takes into account the fact that the higher your net profit, the further you are above the break even point. It's a proven fact that the higher profit businesses have a lower failure rate. Now, I want you to realize is yes, we could've built in a break even point analysis to price the business. The problem is instead of taking you nine or ten minutes to price a business, you would have found that it would've ended up taking you every time a half an hour, an hour longer, and we don't want that because you're trying to come up with a simple system that is also accurate.

When you start to get involved in this thing called net profit, we're really talking about a simplified approach we've taken. I also want you to realize since we have broad parameters here, I already mentioned in the beginning that these are straight line equations. Those of you engineering types or MBA types that like to analyze the math, if you wan to take a point half way between or a quarter way between each value, feel free. It will still be accurate mathematically.

Now, in this case here what we're talking about is basically if you want to analyze it from an example, it's a ship riding in water. The ship is riding at different levels above the water line, and you're going to find the lower your ship rides in the water and the closer to the water line is to the side of your ship, the more waves are going to break over the side. The easier it is to swamp or sink your ship.

If you have a business that's making $20 or $30,000 a year, the weighted value's very small because you're going to find even though you're making a profit, you're going to find as you have different problems in the economy, or your business, or your category industry – again, you don't have them just every few years when you have a recession or every X number of years when we have a depression. You're going to find in business you'll have problems everyday, every hour, every minute, and what you have to do – the more money you have, the more storms you can weather – psychologically and also dollar wise.

As soon as you start to get up over $50,000 you're getting into a very good area, and you start to get into a safer area because very few waves break over the sides of those ships. Even when we have our major recessions, you're going to find the largest increase in the failure rate is in start-up businesses and the Mom and Pops. Why? Because they can not adjust to the inflation or the other problems that they're having during these recessionary periods. What happens is the larger companies are increasing their prices to keep up with inflation or keep ahead. The smaller companies, the break even companies, the Mom and Pops and start-ups have a tendency not to do this, and what happens is they sink further behind, and we have a higher failure rate. Also, these companies don't have the money to weather these storms which the larger ones do, about $50,000.

This business right here, we have a business that shows a profit. Again, what you're going to have to do is you have 5-10 in front of you – turn it over because on the front of 5-10 which is 5-9, we have a net profit. Now, what profit do we use in looking at this? We use the real net profit of $150,000 which gives us a value of what? .44. Do not use the value on number four because if you use the adjusted net profit in this area, you're going to be taking into consideration the return that you built in on your different investments. So, you have to take the real net profit or the money before you backed out the return or the interest rate, whatever you want to call it. So, use the pure number of $150 or you'll end up having done the analysis twice, and you'll goof up your analysis.

Okay, number 23 experience skills required – we're talking about another thing that a lot of people tend to overlook when they're analyzing a business either to buy it or sell it. We're talking about the experience skills required to run this business. If you happen to be the person buying this business, you usually either have the skills or if you're going to build in management, you don't have to have these skills because you're going to end up doing what? You're going to manage the manager who has these skills. Just keep in mind though that the more skill required, the lower value the company has because the more complicated it is the higher the failure rate. The more complicated it is the more difficult it is to higher people to run these companies or to administer these companies.

Now, first of all in this business right here, since we happen to have very few employees and a manufacturing company like 15. You're going to find that you don't have the specific people to do a lot of the functions and the owner or the manager of this company is going to have to have these skills – engineering, bidding, blueprint reading, whatever it happens to be. They're going to have to have these skills.

So, we have some experience required of the owner. This is knowledge that you're going to pick up as you go on and become more knowledgeable at looking at business. So, this is -.09. It's not material, but it's something you should consider. As you then start to get involved in manufacturing companies that have more people and have specific engineers to do different jobs, and you don't require a specific skill other than the management skill of running the company, you're going to find that little or no experience is required by the buyer and or the manager whoever happens to be running the company. Why? You could be easily trained, or if the business is large enough to include experts in all the areas.

Now, keep in mind, the little or no experience area is the one we're talking about the owner or the manager wears loafers. In other words, they can't tie their own shoes. They wear loafers. They bang their head a lot. These are people that require little or no experience.

The other thing if you want to analyze this area and figure out what applies here – these are companies that tend to become franchises because if you're going to franchise something and sell it to people that don't have knowledge in that area, you're looking for something that requires little or no experience. It's sort of idiot proof, loafer type businesses. You don't have to have much knowledge.

A lot of retail stores, as you're going to find in malls, they make $100,000-$200,000 a year profit, and they're run by teenyboppers or they're run by young kids that don't know from A to B. But even though these people are young, you're going to find they do a very good job and these companies do very well.

The other area we talk about is the extensive skills, and we have extensive industry skills required by the owner that means it's very technical. It means that you have to hire a German rocket scientist or it means you have to have a restaurant and you have to have one expert chef. There's nothing wrong with having an expert chef or an expert German rocket scientist. It's just that it makes the business more complicated. It also means that you have another key man in there. In other words, I like to have five chefs, or I like to have my chefs 14 years old. What I'm talking about is I don't want to have a person that's in a key position that's working for me that I have to cowtail to because if that person leaves, I'm out of business or the business isn't going to run very well. So, I like to have ones that have two or three, or I have to have or the person running it would have to have the skill in addition. So, try to stay away from the ones that where we have extensive skills required.

Number 24 – the owner's support after the sales – one of the things that a lot of people worry about and by people I'm talking about buyers, very seldom do sellers worry about it as much as the buyer, and again, the buyer's always worried because the buyer's worried that unless the seller stays for five years, the chances of making it is very small and you're going to find the old saying goes, "Yesterday I couldn't spell Owner, today I are one." What that basically means is the buyer's very nervous going in. Within a week or two after they're in there, they understand the business and they really don't like to have this owner around.

So, what we find is the amount of time and effort that the seller will give the buyer after the sale influences the ability of the buyer to succeed. The more support up to a point, the more chance of success.

So, what we try to do in a lot of these transactions is we have the seller stay around full-time for X number of weeks, up to 40 hours, and then we have the owner stay around up to 30 hours a week, then up to 20 hours a week. We eventually phase them out so that we don't end up with these conflicts between the former owner and the new owner.

In this example here, the owner's willing to stay for a period of time, three months which is over four weeks. So, it's a +.21. Again, that's a good example. We're trying to get them to stay. I know a lot of you are not experienced in business think that you'd like to have the owner stay for a longer period of time. I want you to realize that it doesn't happen very often. It's just because the buyer has hang-ups or the buyer has fear, and usually you're going to find as the average buyer that all you're asking the seller about is where's the light switch? But, don't worry about it. Do not fear in asking the seller to stay.

Why would the seller stay? There's no free lunch. In most cases since the seller is carrying back financing, the seller really doesn't like to leave until they know the buyer can make those payments – no free lunch.

The last one we have here is location. One of the most important assets in the business is location. On this one we have three different levels, and if you're looking at 5-6 in the upper right hand corner, it says "Location class – one, two, three", and Location class three, and it's a rundown industrial park. You say, "Hey, that's terrible. It's crummy." Well, the thing is even though you analyze it and find a location, it's not the best location, and when you come over to pricing, I want you to realize that it's still a level two. It's the average location. It doesn't add to your profit, and it doesn't take away. Why? If you go down to the footnote it said, "Please remember, use level two for businesses in which the location is not important to business such as distributorship, manufacturing."

Now, location maybe important in manufacturing from the standpoint you want to have railroad sidings. You want to have trucks, things like that, but generally you don't have to have a beautiful area. You don't really have to care where you're located because what you're going to find is the average consumer is not coming by your manufacturing plant. It's not like retail. You don't have to have the perfect location. So, don't worry about it. You can go level two.

Now, there are exceptions. You may find in specialty industries like the electronics industry or where you have shortage of labor and the employees insist on having four swimming pools, six hot meals at lunch and all these other benefits that you may find that the location is important. But, generally in manufacturing this is not the case. You can have an ugly building and have a beautiful profit because that's what you're after.

What we do now that we've gone through the 25 is we're going to do a thing that's probably the most difficult because we're going to add these up. Now, you might do this as an example because we have left the plus and minus on page 5-10 blank.

Now, we've circled all these coming up and down. What you have to do now is take all the pluses and add them up. Put the pluses on that little line. We've left that blank for you. What you do then is add up all the minuses and put them on that line. Then subtract the minuses from the pluses. If you get 3.39, we'll give you an "A". If you don't get that, what I suggest you do is do it over again.

Now, for those of you that have those calculators, and these are the calculators without a tape, I would suggest you do it longhand because what you're going to find is by doing it without a tape you're going to make mistakes which means sometimes you're going to overprice the business, which means you're going to goof up. When you underprice it, you're going to irritate the seller if you happen to be a buyer. So, what I'm saying is either go to a tape or do it longhand. Why? So, you can find out what mistakes you make.

So, the end should be 3.39, and what we're saying here basically is we have come up with mathematically the fact that we are going to pay 3.39 years earnings. That's all it says – 3.39 earnings, and we arrived at it mathematically.

If you'll now turn the sheet over, 5-10 back of 5-9, you have now moved 3.39 up into that blank on the top under Section Five. So, it's "Hamel Business Value equals total value plus weighted business value times adjusted net profit." Total value is $190,000. You plug in the weighted business value of 3.39.

Now, what you do first is you multiple the weighted business value by what? Your adjusted net profit. Once you multiply the weighted business value of 3.39 times the $126,800 which is the adjusted net profit from above, you come up with a value of what down below? $429,852, and what is that number? That is the number that we have assigned – that is the value of the goodwill. That is the value of bluesky. That is the value of what we call the intangibles.

Now, the one thing we haven't talked about that I'd like to mention what is bluesky? Well, if you happen to run into a company and the owner is asking for more than the assets and the company makes no money, that's blue sky. But, if the owner is asking for some additional money above what the assets are worth or hard assets like the equipment and the cash, some value above that, that's goodwill. That's real. That's what you're paying for the cash flow, the location, all these other things we just went through.

Once you have these two, we have $190,000 which is the value of the hard value assets, the goodwill is worth $429,852 – and again that's a little more accuracy than we really have. We add the two together. We come up with $619,852, but there's nothing wrong with rounding it off to $620,000. That's accurate enough.

Now, supposing we get to this point and we find out the profit has been running $100,000 and that's what the sheet gave us in Section One up here – net profit of $100,000. We added the other things in. We had a real net profit of $150,000. That was for the year 198x as you'll recall.