

The add-back schedule, broker against quality of earnings

Workbook A, SDE_Bridge. Every line the broker adds back, the figure the quality of earnings accepts, and what was removed. Only the right-hand column is the lender's number.

Business		Prepared by	
Deal		Date	

Line	Broker	After QoE	Removed	Evidence that settles it	Your deal: broker / QoE
Reported pre-tax income, latest year	540.0	540.0	-	Tax return, not the management accounts	
+ Owner's salary	180.0	180.0	-	Payroll register, W-2	
+ Owner's vehicle, phone and insurance	38.0	23.0	15.0	Card statements; which part is the business's	
+ Depreciation	72.0	72.0	-	Fixed asset register	
+ Interest	14.0	14.0	-	Loan statements	
+ One-time legal settlement	25.0	0.0	25.0	Settlement agreement; has it happened before?	
+ Spouse on payroll (non-working)	48.0	48.0	-	Payroll register; duties, if any	
+ Employer payroll taxes on owner and spouse pay	0.0	16.0	-16.0	Payroll tax filings	
- Related-party rent brought to market	0.0	-36.0	36.0	Lease; market rent 72 against 36 paid	
- Customer deposits booked as revenue early	0.0	-31.0	31.0	Deposit ledger, cash to accrual	
SDE	917.0	826.0</			

The quality-of-earnings request list

Workbooks A and B, the QoE column. Each adjustment the two deals needed, the document that proves or removes it, and a column to tick when it arrives.

Business		Prepared by	
Deal		Date	

Request	Why it matters	What it moved here	Received ?	Your figure
Three years of tax returns beside the management accounts	The bridge starts from reported income; the return is the version filed	Cedar Ridge: 540.0 latest year		
Payroll register and payroll tax filings	Owner and family pay, and the taxes on it	Cedar Ridge: +16.0 of payroll taxes		
Contractor (1099) list with hours and supervision	Crews paid as contractors may be employees	Tri-County: -41.0 reclassified		
Lease, and the landlord's identity	Rent paid to the seller is rarely market rent	Cedar Ridge: -36.0 to market		
Customer deposit ledger and revenue recognition	Cash received early is not the year's revenue	Cedar Ridge: -31.0		
Legal files for three years	A one-time item that recurs is not one-time	Cedar Ridge: 25.0 removed		
Card and vehicle statements	The personal share of a business vehicle	Cedar Ridge 15.0, Tri-County 10.0 removed		
Revenue by customer, three years	Concentration: one contract can be most of the profit	Tri-County: the hospital, 34 per cent		
Capex by year and the fleet's age	Catch-up capex is a cost of the price	Cedar Ridge: 150 in year 1, 60 in year 2		
Working capital by month	The peg delivered at closing	Cedar Ridge: 280.0 at the peg		

The price, in four multiples

Workbooks A and B, SDE_Bridge. The same price reads as four different multiples; only the last is on the lender's basis.

Business		Prepared by	
Deal		Date	

Multiple	Cedar Ridge	Tri-County	Your deal
Asking price	3,209.5	1,850.0	
Asking price / broker SDE	3.50	3.60	
Asking price / adjusted EBITDA	4.75	5.57	
Price paid	2,600.0	1,590.0	
Price paid / broker SDE	2.84	3.09	
Price paid / QoE SDE	3.15	3.60	
Price paid / adjusted EBITDA (the entry multiple)	3.85	4.79	
Lender's maximum price at 1.25 (Sources_Uses row 49)	3,282.8	1,595.3	
The book's cash test: cash DSCR of 1.25 in years 3 to 5	2,616.7	1,338.1	

Reading	Cedar Ridge	Tri-County
Does the lender's test pass at the price paid?	yes, 1.56	yes, 1.25
Does the book's cash test pass at the price paid?	yes, lowest 1.26 in year 5	no, 1.10 to 1.12
Would the lender have financed the asking price?	yes, 1.28	no, 1.08

The lender

Sources and uses, with the valuation cap

Workbook A, Sources_Uses. The loan is the smaller of what the equity injection allows and what the appraisal allows. Fill the right-hand column for your deal.

Business		Prepared by	
Deal		Date	

Line	Cedar Ridge	Your deal
Purchase price	2,600.0	
Operating cash cushion	150.0	
Closing costs	95.0	
Catch-up capex financed at closing	0.0	
Subtotal before guaranty fee	2,845.0	
SBA guaranty fee (financed)	63.3125	
TOTAL USES	2,908.3125	
SBA 7(a) loan	2,340.0	
Amortizing seller note, 10% of price	260.0	
Seller note on full standby, 5% of uses	145.4156	
Buyer cash	162.8969	
of which required: 10% of uses less the standby note	145.4156	
of which extra because of the cap	17.4812	
Seller cash at closing	2,194.6	

The cap, three readings	Loan	Buyer cash
Whole loan: loan + paying note <= appraisal (the book's base case)	2,340.0	162.9
Price only: the cap applies to the price, other uses financed	2,357.9	1

The guaranty fee and the loan that sizes itself

Workbook A, Sources_Uses rows 11 to 18. The fee depends on the loan and the loan funds the fee. Each tier is solved in closed form and the consistent one kept.

Business		Prepared by	
Deal		Date	

Tier	Guaranteed share	Fee	Cedar Ridge: uncapped loan if this tier applied	Consistent?
Up to 150	85%	2.00%	2,336.2	no
150 to 700	75%	3.00%	2,348.0	no
Above 700, guaranteed portion up to 1,000	75%	3.50%	2,356.2	no
Above 700, guaranteed portion above 1,000	75%	3.50% to 1,000, 3.75% above	2,357.9	yes

Step	Formula	Cedar Ridge	Your deal
Other uses less the paying note, times (1 - injection)	$0.9 \times 2,845.0 - 260.0$	2,300.5	
Less the tier adjustment	$0.9 \times (3.75\% - 3.50\%) \times 1,000$	2.25	
Divided by 1 - (1 - injection) x fee x 0.75	$1 - 0.9 \times 3.75\% \times 0.75$	0.9746875	
Uncapped loan		2,357.9	
Cap: appraisal less the paying note	$2,600.0 - 260.0$	2,340.0	
The loan, the smaller			

The seller notes, read from both sides

Workbook A and case three. The two notes on one page: their terms, what they are worth to the seller, and what they do to the buyer's first year.

Business		Prepared by	
Deal		Date	

Term	Paying note	Standby note	Your deal
Amount	260.0 (10% of price)	145.4 (5% of uses)	
Rate	7.00%, paid monthly	6.00%, accrues unpaid	
Term	5 years, level payments	full standby while the SBA loan is outstanding	
Counts towards the injection?	no	yes, up to half of it	
Inside the valuation cap?	yes: loan + note <= appraisal	no	
Annual service	61.8	nothing until repaid	
Repaid	by year 5	194.6 at the book's exit, year 5; 260.4 at year 10	

What it is worth	Cedar Ridge	Your deal
Seller cash at closing	2,194.6	
Paying note at the seller's 10 per cent (ADDED)	242.3	
Standby note at the seller's 15 per cent (ADDED)	96.8	
The 2,600 in cash today	2,533.6	
Same value paid all in cash: buyer cash	313.8 against 162.9	
Same value paid all in cash: year-1 cash DSCR	1.04 against 0.96	

Coverage, year by year: the lender's ratio and the cash one

Workbooks A and B, Operations. The lender divides EBITDA by the service. The buyer pays the service from what is left after capex, working capital and tax.

Business		Prepared by	
Deal		Date	

Cedar Ridge	Year 1	Year 2	Year 3	Year 4	Year 5	Your deal, year 1
Adjusted EBITDA	676.0	703.0	731.2	760.4	790.8	
Capex	260.0	174.4	119.0	123.7	128.7	
Working-capital build	0.0	11.2	11.6	12.1	12.6	
Tax	0.0	9.2	15.4	70.7	105.7	
Debt service	432.9	432.9	432.9	432.9	432.9	
Lender's DSCR	1.56	1.62	1.69	1.76	1.83	
Cash DSCR	0.96	1.17	1.35	1.28	1.26	
Free cash to the buyer	-16.9	75.3	152.3	121.0	111.0	

Tri-County at 1,590

The allocation and the tax years

Workbook A, Sources_Uses and Operations. The price allocated by asset class, the first-year deduction under bonus depreciation, and the loss that the 80 per cent rule carries forward.

Business		Prepared by	
Deal		Date	

Asset class	Allocated	Tax treatment	Your deal
Equipment and vehicles	420.0	100% bonus in year 1, or 5-year straight line	
Net working capital at the peg	280.0	no deduction; recovered at book at the exit	
Goodwill and intangibles	1,900.0	15-year amortization	
Closing costs, capitalized	95.0	amortized with the goodwill	
SBA guaranty fee	63.3	amortized over the 10-year term	

Cedar Ridge	Year 1	Year 2	Year 3	Year 4	Year 5
Taxable income before losses	-396.4	154.0	257.1	303.1	352.2
Loss used (at most 80% of the year's income)	0.0	123.2	205.7	67.5	0.0
Loss carried, end of year	396.4	273.1	67.5	0.0	0.0
Tax at 30 per cent	0.0	9.2	15.4	70.7	105.7
Tax, straight line instead	44.3	47.3	54.4	62.2	

The stress pack

Workbook A, Scenarios. One input at a time, the others as shipped. The book's own sensitivities, with a column for yours.

Business		Prepared by	
Deal		Date	

Change	Lender's DSCR, year 1	Cash DSCR, year 1	Buyer cash	IRR	Yours
Base case	1.56	0.96	162.9	64.1 per cent	
Price 2,400	1.69	1.04	168.1	71.6 per cent	
Price 2,800	1.45	0.89	157.7	57.3 per cent	
Price 3,000	1.36	0.84	165.9	49.6 per cent	
Price at asking, 3,209.5	1.28	0.79	176.6	42.6 per cent	
Prime + 1 point	1.51	0.93	162.9	59.3 per cent	
Prime + 2 points	1.45	0.90	162.9	54.7 per cent	
Prime + 3 points	1.41	0.86	162.9	50.0 per cent	
Bonus depreciation off	1.56	0.86	162.9	55.7 per cent	

Revenue lost from year 2	Lender's DSCR, year 2	Cash DSCR, year 2	Free cash, five years</
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The customer concentration worksheet

Workbook B and case two. Revenue by customer is not enough: take each large customer to contribution, to its share of EBITDA and to the part of the price it carries.

Business		Prepared by	
Deal		Date	

Customer	Revenue	Share of revenue	Contribution at the margin	Share of EBITDA	Part of the price at the entry multiple
Tri-County: the hospital system	1,156.0	34.0%	254.3	76.6%	1,218.0
Tri-County: everyone else	2,244.0	66.0%	77.7 of EBITDA	23.4%	372.0

If the largest customer leaves at the first renewal	Tri-County at 1,590	At 1,338	Your deal
Lender's DSCR, year 2	0.30	0.36	
Personal cash put in over five years	738.1	531.0	
SBA balance still guaranteed at year 5	890.0	749.0	
New revenue to restore 1.25 in year 2	1,107.1	875.	

The walk-away price: two tests and the guarantee

Workbooks A and B, and case one. The lender's test sets a ceiling. The buyer's test, cash coverage of 1.25 once the tax shield has gone, sets the price. The guarantee sets what is at stake.

Business		Prepared by	
Deal		Date	

Test	Cedar Ridge	Tri-County	Your deal
Price paid	2,600.0	1,590.0	
Lender's maximum price, DSCR 1.25	3,282.8	1,595.3	
Price at which the cash DSCR is 1.25 in the weakest of years 3 to 5	2,616.7 (year 5)	1,338.1 (year 3)	
Walk-away price: the lower of the two	2,616.7	1,338.1	
Price paid against the walk-away	16.7 below	251.9 above	
Cash DSCR, weakest of years 3 to 5, at the price paid	1.26	1.10	

What is at stake beside the return (Cedar Ridge, case one)	Figure	Yours
IRR on the buyer's cash	64.1 per cent	
Buyer cash	162.9	
SBA debt personally guaranteed	2,340.0	
Guarantee over cash	14.4 times	
Personal cash at 10 per cent of revenue lost, five years	273.2	
Guarantee called if liquidated at year 3, no shock (ADDED recoveries)	1,227.3	

The exit, allocated by asset class

Workbook A, Exit_Returns. The sale at the end of year 5 at the entry multiple, split by class, with the recapture that bonus depreciation and amortization leave behind.

Business		Prepared by	
Deal		Date	

Line	Cedar Ridge	Your deal
Exit-year EBITDA	790.8	
Exit multiple (the entry multiple)	3.8462	
Gross value	3,041.6	
Selling costs, 6 per cent	182.5	
Working capital, at book	327.6	
Equipment, economic value	593.3	
Goodwill, the residual	1,938.3	
Equipment gain, all recapture	593.3	
Goodwill gain, all recapture of 665.0 amortized	608.3	
Ordinary income / capital gain	1,201.6 / 0.0	
Unamortized guaranty fee deducted	31.7	
Exit tax	351.0	
Debt repaid: SBA, paying note, standby with interest	1,650.0	
Cash cushion the buyer keeps	150.0	
Net exit proceeds to the buyer	1,008.1	

Returns	Cedar Ridge	Tri-County
IRR on cash equity	64.1 per cent	57.3 per cent
Multiple, received over paid in	8.17	6.55
SBA debt personally guaranteed	2,34	

The two deals on one page, and the order of work

Workbooks A and B, Inputs. Both fact patterns for rebuilding either deal, and the order in which the questions get asked.

Business		Prepared by	
Deal		Date	

Item	Cedar Ridge (Deal A)	Tri-County (Deal B)	Yours
Revenue, three years	4,620 / 4,980 / 5,310	3,050 / 3,260 / 3,400	
Reported pre-tax income, latest	540	318	
Broker SDE / QoE SDE / adjusted EBITDA	917 / 826 / 676	514 / 442 / 332	
Asking / price paid	3,209.5 / 2,600	1,850 / 1,590	
Working capital at the peg / cushion / closing costs	280 / 150 / 95	200 / 100 / 70	
Equity injection / standby note / paying note	10% / 5% of uses / 10% of price	the same	
SBA rate / term / minimum DSCR	prime 7.00% + 3.00% / 10 years / 1.25	the same	
Growth / capex / equipment allocated	4% / 110 + catch-up 150 and 60 / 420	3% / 25 / 90	
Tax rate / loss limit / goodwill life	30% / 80% / 15 years	the same	
Exit / selling costs	year 5 at the entry multiple / 6%	the same	
Concentration	none named	hospital, 34% of revenue	