[M/S -17] Fair Market Value Estimate #1 http://fastbooks.solutions/website-tutorial-ss-17 1-Capitalization of Earnings Method -See cell [F31]: 2-Discounted Future Income Method -See [M/S -18] cell [J30]: Average of the [2] Estimated [F-M-V] Appraisal Calculations: Internal Return Rate -[Calculation]: Note: As with all yellow highlighted cell; both the financial rates and financial criteria used in the above [build-up-method] matrix can is replaceable with either different percentages or criteria. An essential step within the calculation of estimating an [F-M-V] for a [non-public] service based business is to subtract the current total payroll and related expense for the business owner. This cost then replaced with an estimate entered in the cell [C20] of a fair market value compensation package for the business to hire a person to perform the current duties of the current business owner. (Leave cell [C20] blank if not applicable.) The matrix below is known as the [build-up-method] used to create a Capitalization-Rate:

Definition of Fair Market Value:

The price at which a business will sell when offered for sale by a willing seller and purchased by a willing buyer, allowing reasonable time in which to find such a buyer and acting prudently with full knowledge of the related facts, neither being under compulsion.

Definition of Discount and Capitalization Rates:

The Discount and Capitalization rates are needed for estimating the value of businesses. Both rates are used to convert income measures into value estimates and are particularly useful for valuing closely held businesses. The main difference between the two is that a Discount Rate is applied when the discounted future income method is used for valuation purposes whereas a Capitalization Rate used when the capitalization of income method is applied. The two, however, are related since a Capitalization Rate is essentially the Discount Rate without the projected long-term growth rate of future income.

Developing a Discount Rate:

The method used above is the build-up method. This method simply says that a discount rate is the sum of a "risk-free" return (such as) U. S. Treasury notes or bonds). Plus, the additional risk premium required by the market to invest in stocks in general, plus a risk premium for any additional risk inherent to the specific industry valued.

Definition of Perpetuity Growth Rate:

Accounts for the value of Free Cash Flow that continues into perpetuity in the future, growing at an assumed constant rate.

Definition of Free Cash Flow:

A measure of financial performance calculated as operating cash flow minus capital expenditures. Free Cash Flow (FCF) represents the cash that a company can generate after spending the money required to maintain or expand its asset base. FCF is important because it allows a company to pursue opportunities that enhance shareholder value. Without cash, it's tough to develop new products, make and pay dividends and reduce debt.

Definition of Business Owner Normalization Compensation Adjustment:

A [non-public] Service Based Business evaluates profitability after accounting for the base salary of the business owner before considering business profits. The excess business income after compensating the owner for performing business services belongs to the owner.

The owner may perform revenue-generating services; however, accounting for their total compensation allows the value derived from business ownership to be evaluated separately from the total profit derived from the enterprise. The software provides a methodology for the owner's total compensation be fixed at an appropriate dollar value to consider the future value of the businesses ownership in the [Fair Market Value] calculation.

1 - Capitalization of Earning Valuation Method:



This method capitalizes the Net Income from the business at a rate at represents a Fair Return for a similar practice at a particular time, considering the risk involved. The key elements are the determination results of this calculation reflected in cell both cells [F25] and [C4]:



Revenue: -[Activity Base #1]:	
Payroll and Related Expenses: (See Note -1)	
Subtract: Owner Normalization Compensation Adjustment:	
Dental Supplies and Lab Fees Expense	
All Other Business Expenses:	
Add Back:	
Depreciation Expense:	
Interest Expense:	
Amortization Expense -The [4] unassigned acct #'s [19 -17-20] are intended for	
similar uncommon expenses. Enter: -Annual Amortization Expense in cell [F24]:	
Ordinary Business Income (loss):	
Federal Tax -Enter Federal Tax Rate:	
Calculated Federal Taxes	
Net Income from Operations after Federal Tax:	
% of Revenue:	
Capitalization Rate:	
F-M-V Estimate under the Capitalization of Earning Method:	

Definition of Capitalization of Earning Valuation Method:

The capitalization of earnings method looks to the actual historical results of business as an indicator of results in the future. This technique typically involves dividing a business's annual historical earnings by a "capitalization rate" which incorporates risk (the discount rate) and a factor for future annual growth. The measure of income that capitalized is most frequently the after-tax income of the business, although the approach can use with pre-tax earnings, earnings before interest and taxes, measures of cash flows, and other measures. In this model, we selected the "Operational Net Income" of the business to capitalize.

Definition of Operational Net Income:

% of Annual Revenue Forecast:

After-tax income (excluding depreciation, amortization and interest expense). The reason we selected Operational Net Income as the numerator was that for a service based businesses it is the best measurement that approximates "Free Cash Flow" without undergoing an in-depth balance sheet analysis that could get down to analyzing journal entries.

The Formula for Free Cash Flow:

Net Income from Operations After Tax

- Changes in Working Capital
- Capital Expenditures
- = Free Cash Flow

Some believe that Wall Street focuses myopically on earnings while ignoring the "real" cash that a firm generates. Accounting gimmicks often cloud earning, but it's tougher to fake cash flow. For this reason, some investors believe that FCF gives a much clearer view of the ability to generate cash (and thus profits). For this software, we felt that it would also be appropriate to add back Interest Expense because we felt it does not reflect on a service based business ability to generate cash flow.

It is important to note that negative FCF is not bad. If FCF is negative, it could be a sign that a company is making large investments. If these investments earn a high return, the strategy has the potential to pay off in the long run.

When applying a Capitalization Rate to a business appraisal, the following following business factors is important to consider. The Capitalization Rate is analogous to a "return on investment." Bear in mind that the healthier the business, the lower the capitalization rate, resulting in a lower overall risk in business which increases the value of the investment.