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New SBA Regulations Create Valuation Requirement

The SBA has been under close scrutiny of the Congress of late, with rising default and charge-off rates involving both real estate and business loans likely to intensify their oversight. The "housing meltdown" and "mortgage crisis" are now household words and part of the American psyche, but relatively little is known about the SBA's role in assisting small business owners obtain "guaranteed" financing from banks and other financial institutions.

The benefits to buyers and sellers from using SBA-guaranteed financing are many, with the costs largely falling on the shoulders of taxpayers and to a lesser extent the buyer/borrowers. In short, the SBA's 7(a) program allows buyers to acquire a going concern with as little as 10% cash down while providing the seller with as much as 90% cash at closing. Other benefits include an extended repayment term (10 years for business loans and longer for "blended" business and real estate loans), below market financing (less than seller financing rates) and improved marketability for business owners interested in selling.

After a long and often contentious exposure period and a subsequent revision, a new set of SBA regulations have taken effect which requires **independent appraisals** from **qualified** sources. The primary set of SBA regulations related to their loan programs are found in the so-called "SOP50-10(5)", which covers 7(a) and 504 loan processing as well as the requirements to become and remain a 7(a) lender or a Certified Development Company (CDC). Included in this 400 page plus document are several paragraphs which address the role played by business valuation and business appraisers.

Among the many changes found in the revised SOP, there are ultimately two pivotal changes. In summary, these two changes are as follows:

1) Beginning 8-1-08, every SBA-guaranteed business acquisition loan over $350,000 **MUST** be supported by an independent appraisal performed by a "qualified source".

2) A "qualified" party is now, for the first time ever (this was one of the "technical" corrections), a person who regularly receives compensation for business valuations AND who is accredited by a recognized organization.

The fact is that prior to these changes, the individuals and companies performing such appraisals were not always certified and the specific cases which required "independent" appraisals were extremely limited, e.g. the subject business is being bought and sold by

continued on page 3

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Business Valuation and Litigation Support Services is headed by David Pieton, Certified Public Accountant and Accredited Senior Appraiser. Dave's experience crosses industry as well as geography having served a wide variety of businesses in Pennsylvania, Ohio and California over the past 25 years.

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There are numerous quantitative and qualitative factors one must consider in selling a business. A recent New York Times article sums up a few of the qualitative factors and provides good advice for sellers wishing to remain with the buyer. We have reprinted this article, with permission, below:

Staying on After Selling

After Selling the Company, Remorse

Christopher A. Baker had two goals when he started his company, MailCode, in 1989: to build a successful business and to sell it one day. He achieved both.

But what he had not taken into consideration were the challenges he would face as he stopped being the head of a small start-up and became a cog in the wheel of a major corporation. In his case, it was Pitney Bowes, the producer of postal meters and other mailing equipment, that acquired MailCode, a maker of large automated postal sorting machines, in 2001 for more than $20 million.

As part of the deal, Mr. Baker, now 41, continued to run MailCode for 18 months out of his hometown, West Lafayette, Ind. Then he moved to the Pitney Bowes headquarters in Stamford, Conn.

Although he said he was thrilled with the sale, he worried about what lay ahead — especially since he decided to take a position with the new owner. "Any time you sell you have mixed emotions," said Mr. Baker, who was until recently the president of Pitney Bowes Group 1 Software, in Lanham, Md. "You're about to get a huge payday, but you have no idea what the future holds for you."

Most entrepreneurs share the same vision: to sell their darling for big money and watch it flourish in its next incarnation. According to Mitchell Schlimer, the founder and chief executive of the Let's Talk Business Network, a support community for chief executives and entrepreneurs in the New York area, about 90 percent of small business owners who sell their companies remain with the acquiring company, at least for a few years.

"They often don't stay longer than that because most entrepreneurs are not good soldiers," Mr. Schlimer said. "Not to say that some can't be, but most entrepreneurs are all about the initial journey — that's where their strengths are, making something from nothing and all the creativity that goes along with it."

You're trying to maximize the value of your company when you're selling it — and then when the transaction closes, that individual is your boss. It was very difficult.

Indeed, like stepfamilies trying to blend together, the transition from single household to Brady Bunch is often harder than most entrepreneurs anticipate. Either the former owners have trouble giving up control, or they find the new office culture radically different from what they were used to, or they simply cannot bear to see what the new owners are doing to their creations. It can be wrenching even in the best of circumstances.

"It's like giving up a child," said Tova Borgnine, the founder and chief executive of the Tova Corporation, a cosmetics and fragrance company now owned by the televised home shopping company QVC.

In March 1977, Ms. Borgnine, who is married to the actor Ernest Borgnine, started a mail-order company in Los Angeles selling a perfume called Tova Signature.

By 1987, she had 65 skincare products and 80 employees. In 1990, she began selling her wares on QVC, and 12 years later QVC bought the Tova brand for a seven-figure sum. Tova Signature is QVC's top-selling perfume.

It was, she said, an accomplishment she was proud of, but still an adjustment. "In a massive corporate structure you have bureaucracy that you must be able to get through," said Ms. Borgnine, who divides her time between Beverly Hills and Malvern, Pa., near QVC's headquarters. "All of the products are the same as when I created my company; I'm in on every strategy meeting, but now there's a collective voice. That's a luxury, but you've also got to be able to let go.

Jerry L. Mills, the founder and chief executive of B2B CFO, with headquarters in Phoenix that offers business advisory services, has helped hundreds of clients through the business acquisition process. Most wrestle with the fact that they still have the responsibility, but not the authority. "They make decisions that are sometimes reversed by their boss. It's embarrassing," Mr. Mills said.

It can also be upsetting, especially when the new owners drive the business into the ground and the founder has to watch. In 1995, for example, Christopher J. Asterino, the co-owner of Asterino Associates, a medical billing management firm in Albany, sold his 10-year-old company for more than $1 million and moved to Scottsdale, Ariz., to be vice president for acquisitions for the new owner, National Medical Financial Services.

He had a terrible time of it. For starters, he said he found the relationship with his new boss "weird."

"The person who became my boss was the man I was negotiating with when I was selling my company," said Mr. Asterino, 46. "You're trying to maximize the value of your company when you're selling it — and then when the transaction closes, that individual is your boss. It was very difficult."

Mr. Asterino said he was disappointed at how the new owners ran the business and dealt with clients. Eventually, he said, he could no longer bear to watch it and left the business in 2000, and started another medical billing firm, Asterino & Associates. "The great lesson that came out of that five-year period was how not to do it," he said. "It was a very expensive lesson to learn."

Mr. Baker, who is currently taking a leave of absence from Pitney Bowes, also has a failed merger under his belt. In 1996, he sold MailCode to Postal Soft, a privately held company in La Crosse, Wis.

At first it seemed ideal, but soon the new owner ran into financial difficulties. "They needed us to stop spending on R&D and focus all of our energies on existing products," he said. He refused, and bought the company back a year later for the same price for which he had sold it. Three years later, he sold it to Pitney Bowes, where he is happy, although he, too, had an adjustment period.

"The culture shift wasn't hard, but every one of my peers wondered why I wasn't on the beach drinking a Mai Tai," he said. "They knew I had the money in the bank. I wasn't one of them. I had to work as hard as everyone else. If an entrepreneur joins a company with an open mind to learning, there's an incredibly valuable experience there with powerful rewards. But if you don't have that mindset, you won't make it a year."

As for Mr. Asterino, he has no intention of selling until he is ready to retire. "It would take an extraordinary unique set of circumstances to allow me to change my quality of life, my entrepreneurial business thinking and my ability to make decisions based off of relationships and not profits," he said.

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continued from page 1

related parties or the business was already subject to a current SBA loan taken out within the previous 3 years. Although certain lenders sought to take the high road and hired only credentialed appraisers and requested appraisals even when they were not formally required, it is safe to say that the majority of lenders sought the lowest cost alternatives in most instances.

A "qualified source" is an individual who regularly receives compensation for business valuations and is accredited by a recognized organization. Some recognized organizations and the accreditations they provide include: 1. Accredited Senior Appraiser (ASA) accredited through the American Society of Appraisers; 2. Certified Business Appraiser (CBA) accredited through the Institute of Business Appraisers; 3. Accredited in Business Valuation (ABV) accredited through the American Institute of Certified Public Accountants; and 4. Certified Valuation Analyst (CVA) accredited through the National Association of Certified Valuation Analysts. The lender may not use a business valuation provided by the seller or the buyer to meet these requirements.

A new set of SBA regulations have taken effect which requires independent appraisals from qualified sources.

In light of this new requirement, potential acquirers could avoid time delays and additional costs if the business valuation requirement is known and planned for at the onset of negotiations. Many of the valuation procedures could be accomplished through the due diligence process and the independent value opinion could sway the ultimate negotiation and final price.

Our valuation professionals at KFMR Katz Ferraro McMurtry P.C. are "Qualified Sources" and have provided extensive lender based valuations over the years. Please call us with any questions.

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