



The logo for Internet Business Basics features the text "internetbusinessbasics" in a blue sans-serif font. Above the text are four orange circles of varying sizes, arranged in a slight arc.

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“This paper is intended to condense and present to the reader a practical guide to formulating and writing a business plan.

Your company’s business plan is the single most important business proposal you will ever write. There are many aspects of a business plan that will gauge your success. If you have any reservations about your plan, by all means, do not be afraid to get guidance from plan writing manuals or consultants. It will pay off in the end.

The bottom line is that finding and asking the right investors take effort and expense, therefore, do not throw your efforts away by sending lenders a poorly devised business plan. Lastly, finding money takes time and energy. Be diligent, and above all be patient.”

- JOHN SHENTON .. PRESIDENT

1 PRE-INCORPORATION AGREEMENTS

If you are just starting your business, we recommend you take a moment to peruse the following elements and issues that need to be considered before you move forward. Failure to consider the ramifications of these issues can adversely affect future operations. It is understood that having the entire founding team on the same sheet of music with respect to these issues will greatly simplify the startup process. Notice also that the development of the business plan comes after these issues have been decided.

1.1 Company Structure

- Corporation, Partnership, Limited Partnership, Sole Proprietor, S-Corp, LLC, LLP
- Name, Affiliated Companies
- Company Purpose and Mission
- Long Range Goal, Exit Strategy

1.2 Organization and Management

- Corporate By Laws, Officers, Directors, Meetings
- Compensation and Incentives
- Organizational Structure and Personnel

1.3 Founders Stock Ownership

- Authorized and Issued
- Buy/Sell Agreements
- Transfer Restrictions
- Key Person Provisions and Insurance

1.4 Accounting and Finance

- Initial Capitalization, tax considerations
- Owner Asset Assignments
- Loans, Application, Conditions & Sources

1.5 Selection of Professional Team

- Partners/Founders Team
- Legal and Accounting
- Banking and Finance
- Advertising and Marketing
- Key Consultants
- Board of Directors

1.6 Business Plan

- Purpose and Executive Summary
- Business Description
- Market Studies and Marketing Plan
- Financial Pro-Forma's and Break Even Analysis

2 POTENTIAL BUSINESS PROBLEMS

Every day we receive calls from entrepreneurs seeking venture capital for business expansion. All too often, the perceived need for additional funding is really a need to become more efficient, using resources already available and increasing marketing efforts. The Business and Financial Fitness Quiz at the end of this paper will provide an in-depth analysis of your business.

The following are problems directly attributable to management that cause businesses (and governments) to get into financial trouble according to Corporate Economist Philip B. Nelson:

2.1 Errors of omission

- Lack of planning to cover increasing debt or interest rates [23.3%]
- Changes in the market place (nothing stays the same) [66.6%]
- Technological changes to the market that bypass your company [13.3%]
- Changes in the physical environment (often occurs slowly) [3.3%]
- Disruption of key relationships (loss of key clients, financing, etc.) [36.6%]

2.2 Errors of Commission

- Over expansion (too many employees, offices, products) [66.6%]
- Over leverage (works great during expansions, remember the "bubble") [53.3%]
- Over diversification (what business are you really in and what makes the money?) [40.4%]
- Over dependence on one customer, supplier, product, etc. who suddenly disappears or changes the relationship [13.3%]
- Inadequate control systems (does your accounting, manufacturing, etc. system give you the answers you need right now?) [80.0%]
- Dissension among the management team (it is a team isn't it?) [40.0%]
- Has the business reached its "level of incompetence"? [46.7%]
- Lack of leadership by the chief executive. [83.3%]

3 SOLUTIONS AND CONTROL SYSTEMS

Now that you have identified the potential or actual problem, what can be done to avoid or correct them?

- It is vitally important to avoid denial of the problems.
- Early recognition of the symptoms of a sick company, and willingness to act is the best hope for an early and successful recovery.
- Not letting yourself fall for "escape hatches" and last minute "saviors".
- Being willing to put the survival of the business above personal agendas and competing issues.
- Getting professional help early and often. Have you done everything possible to control all costs? Can you automate, use part-time help, re-negotiate rents, restructure responsibilities, out-source production, etc.?
- Are there ways that you can use current assets (both people and tools of the trade) in a more efficient manner?
- Have you explored ways to increase sales, and are there enough margins to allow expansion of your sales efforts? Many companies make the mistake of cutting sales commissions and incentives during difficult times when just the opposite is called for.
- Are advertising dollars quantifiable? Can you measure the effectiveness of your advertising? Does your advertising follow your marketing plan?
- Knowing "when to close and walk away".
- Most importantly not running away from the problems.

If, after a thorough evaluation, you determine that you really do need expansion capital, there are numerous ways to obtain funding that do not require formal venture capital.

Assuming the previous sections have been well assimilated, the following section outlines the philosophy and methodology to write a successful business plan.

4 BUILDING A GROWTH COMPANY

4.1 Ten Commandments

1. **"Pre Incorporation Agreement"**. Limit the primary participants to people who can consciously agree upon and contribute directly to that which the enterprise is to accomplish, for whom, and by when. Only consider investors that bring more than money to the table: e.g., connections, marketing skills, technical expertise, etc.
2. **"The Customer is King"**. Define the business of the enterprise in terms of what is to be bought, precisely by whom, and why. Missionary marketing without testing the market prior to development of a product is the formula for disaster.
3. **"Use a Rifle not a Shotgun"**. Concentrate all available resources on accomplishing two or three specific, operational objectives within a given time period.
4. **"Failing to Plan is Planning to Fail"**. Prepare and work from a written plan that delineates who in the total organization is to do what, by when. Use your business plan as a budget. If you could not stick to that budget then your business plan is too ambitious.
5. **"Don't Pick a Quarterback to Block"**. Employ key people with proven records of success at doing what needs to be done in a manner consistent with the value system of the enterprise. When in doubt hire your biggest or best competitor's key people. Free agency works in business too.
6. **"Reward the Superstars"**. Reward individual performance that exceeds agreed upon standards. Move the non-producers into administrative positions or replace them.
7. **"Is Bigger Really Better?"**. Expand methodically from a profitable base toward a balanced business. A smaller, more focused business can sometimes be far more profitable and stable than a large and fractured one.
8. **"Cash Flow is King and the Secret of a Good Nights Sleep!"**. Project, monitor, and conserve cash and protect credit capability. Over expansion, failure to see future trends or competition, and poor credit policies are your biggest enemy.
9. **"Nothing Personal, but Your Fired"**. Maintain a detached point of view. Never hire family or friends unless you are also willing to fire them. Be decisive and do what is best for the business (this could include firing you and hiring a more qualified manager!).

10. **"The Only Universal Constant is that Everything Always Changes"**. Anticipate constant change by periodically testing adopted business plans for their consistency with the realities of the world market place.

Following are a list of seven key elements to keep in mind in the overall preparation of a business plan.

4.2 Seven Point Check List for Your Business Plan

1. Can you successfully operate the company?

Alternatively, does your resume show that your experience is in company operations? Make sure that if you do not possess all of the skills to run your company that you have hired the talent to do so.

2. Does your Pro Forma demonstrate the ability to repay the loan?

Be certain you provide a complete ratio analysis to the prospective lender.

3. Have you conducted a complete market analysis?

It is important to show that your product or service will actually be in demand in the quantities that your Pro Forma states.

4. Is your plan easy to follow?

You should index and tab your plan, and create a table of contents so the lender can easily refer to various sections. In addition, check to ensure the flow of information in the table of contents is logical and realistic.

5. Did you write an executive summary and put it at the beginning of the plan?

This is your company's cover letter. It will be the first thing the lender reads. It needs to spark sufficient enthusiasm to maintain the reader's interest.

6. Is the plan grammatically correct?

If you are not sure, hire someone to help you. Spelling and typographical errors denote a careless approach to detail.

7. Have you provided beyond any reasonable doubt that your product or service will work or is needed?

Be prepared to provide working models if necessary.

4.3 Is Your Business Plan On-Target?

Prospective lenders do not act upon business plans that are not informative or exciting. The following steps outline important facets of the business plan that a lender will review **after the financials**. Many business plans fail to raise money because of the orientation of the business plan, i.e., the plan focuses on the product or service, not the financials.

4.3.1 Focus on the product.

Furnish all pertinent details about your product or service, including any research you have conducted. What development stage is it in? How is it unique? What are your distribution methods? Who will use your product and why? What does it cost to

manufacture, and what is the selling price? Describe future plans for updates and new releases. Involve the lender in the product or service so they will be as excited about it

as you are. Try to describe everything in simple terms. (*Remember, items and attributes that are clearly defined to you are not always clear to others*) The goal is not only to convince the lender that your product will revolutionize the world, but that you have the facts to prove it!

4.3.2 Why you and not your competition.

Analyze your competition in detail. Who are they? How do their products work? How are they similar to and different from your product? What are their marketing tactics? Define each competitor in terms of sales volume, gross margin, income and market share. Then discuss your company's competitive advantage over each one. Do not vilify the competition. Instead, show why a customer chose your product over the competitors due to its quality, delivery time, location, price, etc. Convince the reader that you're not only a worthy competitor, but your company will be setting industry standards in the future. Make the lender aware that you know the risks your competitors bring, and take them on a journey through your dynamic plan to overcome each one.

4.3.3 Know your markets.

Provide an in-depth analysis on how your company perceives its target markets. What are the economic, geographic, occupational and psychological profiles of the people who will buy your product and how will each benefit? Develop and include a preliminary marketing plan. List where you intend to advertise, promote and publicize. Make sure to include budgets and project revenue for each. Also, include an outline of your sales strategy. Do you use outside sales representatives or an in-house sales force? Do you use resellers, distributors or franchises? What sales training will you provide? Again, details are paramount.

4.3.4 Present your course of action.

How exactly do you intend to get your product out to the public? How is your product being assembled? What materials do you use? What production resources do you own or need? What are the costs for equipment and manufacturing? Do you own or lease the facilities? Explain both the fixed and variable costs related to assembling, storing and delivering your product.

4.3.5 Show off your management team.

The key to turning an idea into a successful venture is to have a strong management team. The team must have in-depth technical knowledge, managerial skills and years of experience. It is management's responsibility to plan, organize, control and direct the activities of a company towards its goals. Describe the team and its responsibilities as a whole first. Then break down each member's special skills, attributes, and

accomplishments, indicating how each will benefit your company. Describe management objectives and include organizational charts to support your claims.

4.3.6 Make your executive summary shine.

Does your executive summary leave the reader intrigued and thirsty for more information? It should, because it will leave a lasting impression. It will be the last thing you write but the first thing the lender will read, and should summarize the most pertinent details from the plan. Include a brief yet captivating overview of your position within the company, the company's capabilities and limitations, the competition, marketing and financial strategies, and the management team. This is your company's cover letter, so make it good.

4.4 How Investors Read a Business Plan:

It is important to realize that a potential investor will initially spend only 10 -15 minutes with your plan. The following areas will be evaluated, each area taking a few minutes!

4.4.1 Determine the characteristics of your industry and company

- What other public or privately held similar companies are there?
- Is there a larger company that is extremely successful
- Is the company in an exciting market? (important to ensure a good public offering)

4.4.2 Determine the terms of the deal

- How much of the company is being sold for what price?
- What is the form of debt or equity being requested?
- How will the funds be used? Retire old debt (*not a good idea*)? Undertake new activities that will in turn increase profitability,

4.4.3 Review the bottom line emphasis years two though five.

- Earnings are reviewed to determine company's valuation

4.4.4 Determine the caliber of the people in the deal

- What is the record of accomplishment of the founders and managers?
- How much balance and experience does the inner management team possess?
- How long have the members worked together?
- Who are the bankers and accountants and what are their credentials?

4.5 Investors Questions Answered by the Business Plan:

- How much can I make?
- How much can I lose? (including loan guarantees, opportunity cost, and non financial considerations)
- What is unique, innovative or technologically different?
- What is the perceived value of your product versus what your product actually does?
- Why will everyone need your product or service?
- What will happen to your customers if they don't buy your product or service?
- Who says this is a good investment?

5 BUSINESS PLAN DOCUMENTATION

There are several stages of documentation required by most funding sources during the venture capital process. They are usually tailored specifically to both the funding source being approached and the stage of your business. The primary documents are outlined below:

5.1 Business Plan Do's and Don'ts:

- DO keep the business plan as short as possible without compromising the description of your venture and its potential. Remember venture investors are not patient readers.
- DO NOT over-diversify your venture. Focus your attention on 1 or 2 key products or services.
- DO NOT have unnamed mysterious people on your management team who will join your company later.
- DO NOT describe technical products or manufacturing processes with jargon that only an expert can understand.
- DO NOT estimate your sales on the basis of what you can or would like to produce.
- DO NOT make ambiguous, vague or unsubstantiated statements. Be precise about market size, rates, etc.
- DO involve your management team in the preparation of the business plan.
- DO disclose any current or potential problems with your venture.

5.1.1 Market Feasibility Study:

Basic research done principally by the entrepreneur to identify a market niche for the product or service to be offered. Identify the size, dynamics, competition, and other factors effecting the proposed business operation before investing large sums of money or proceeding with a "missionary marketing" venture with little or no chance for success.

5.1.2 Executive Summary:

An outline of the complete business plan, usually only 1-3 pages long. Includes and describes principal markets, personnel, financial highlights, and the proposed deal structure. The Executive Summary is developed from the completed business plan and summarizes the project.

5.1.3 Business Plan:

Contains the complete plan for the business for the next two to five years. The table of contents for a business plan can be found in the next section. **(Each business will**

require some or most of the sections outlined.) The business plan financials should include low, medium and optimum projections for various market conditions.

5.1.4 Business Valuation Study:

A document that includes several business valuation studies showing business values before and after investment. Business valuations allow you to determine how much stock to sell for the money you are raising. Extremely important when you are trying to raise money for a business that will be a candidate for a merger, acquisition or an Initial Public Offering (IPO) later. Required for funding by professional investors so that adequate returns on investment are shown.

5.1.5 Investment Plan:

Document outlining in further detail the timetable of required equity and debt financing, and the payback, or liquidation, of the investors' position under various scenarios. This is where the "Deal" is structured to make your business attractive to investors and lending institutions.

5.1.6 Due Diligence and Supporting Documents:

Include all additional information to support and supplement the business and investment plans. Do your own Due Diligence on the sources of funds and the funding sources before making a deal. Before funding, all sources will require Due Diligence information. You should begin assembling a notebook or package of documentation as soon as possible.

5.1.7 Legal Requirements

Provincial and Federal Securities laws must be observed in all cases when seeking equity capital and debt financing. Before any action taken in raising funds, a securities attorney will be required to render an opinion on each project as to the requirements specific to that business. Consulting a CPA and a Tax Attorney are also recommended.

5.1.8 Full Disclosure

Full disclosure is the law! Please remember that in order to get your project funded you must look at everything with a microscope. Everything that is outlined in the business plan, valuation study, financing plan, and due diligence package will be verified by third party references or audited by the investing party or bank funding your project.

It is a criminal and civil offense to either misrepresent or omit material facts that would effect the decision of the investor or lending institution.

Should you proceed with the funding of your business, all the information required in the Due Diligence List will be thoroughly checked by the funding sources used, whether it is a bank, venture capital company, private or public company or a private investor.

The process is called "Due Diligence", and is a legal requirement for all persons in a fiduciary or responsible position.

5.1.9 Presentation Package:

Your marketing package used to present your program to others. May be a short series of color slides or overheads used when talking with investors or banks. It is your marketing package, developed along with your business plan and enhances your chances of funding. This is the "Road Show" presentation.

Your completed Business and Investment Plan is a blueprint for the success of your business. It should be a living document that is revised and updated periodically as conditions change, or when new markets and products are developed, additional funding is obtained, or economic conditions change. It is recommended that your management team perform at least a semi-annual review.

Preparation of these documents early in the development of your business will assure both you and the investors that every option has been considered prior to launching or expanding your business. These plans and their supporting research must be developed with the active participation of the principals of the company. In many cases, both new markets and/or significant changes in company focus will result from the preparation of your plan.

6 BUSINESS PLAN OUTLINE

6.1 Executive Summary

(what's in it for investor? 3 pages maximum)

- A. Disclaimer page,
 - 1. Registration number,
 - 2. Return instructions
 - 3. Non-proprietary
- B. The Purpose of the Plan
 - 1. Attract Investors
 - 2. Document an operational plan for controlling the business
 - 3. Test the financial feasibility of a business concept
- C. The Company
 - 1. The needs your company will satisfy
 - 2. The products or services you will offer
- D. Market Analysis
 - 1. The characteristics of your target market (demographics, etc.)
 - 2. The size of your target market
- E. Product or Service Research and Development
 - 1. Major milestones
 - 2. Ongoing efforts
- F. Marketing and Sales Activities
 - 1. Marketing Strategy
 - 2. Sales Strategy
 - 3. Keys to success in a competitive environment
- G. Organization and Personnel
 - 1. Key managers and owners
 - 2. Key operations employees
- H. Financial Data
 - 1. Funds required and their use
 - 2. Historical financial summary
 - 3. Prospective financial summary (brief justification for sales projections)
 - 4. Valuation and Deal Structure
 - 5. Valuation summary and methods used

6.2 Table of Contents

6.3 Company Description

- I. Nature of your business
 - 1. Market place needs to be satisfied
 - 2. Method(s) of need satisfaction
 - 3. Individuals or organizations with those needs
- J. Your Distinctive Advantages; Primary Factors of Success
 - 1. Superior customer need satisfaction
 - 2. Production/service delivery efficiencies
 - 3. Personnel
 - 4. Geographic location

6.4 Market Analysis

- K. Industry Description and Outlook
 - 1. Describe primary industry
 - 2. Size of the industry
 - 3. Historically
 - 4. Presently
 - 5. In five years
 - 6. In ten years
- L. Industry characteristics and trends (life cycle)
 - 1. Historically
 - 2. Presently
 - 3. In the future
- M. Major customer groups
 - 1. Business
 - 2. Government
 - 3. Consumers
- N. Target Markets
 - 1. Distinguishing characteristics of target markets, narrow focus to manageable size
 - 2. Critical needs
 - 3. How needs are now being met
- O. Demographics
 - 1. Geographic Location
 - 2. Purchase decision makers

3. Seasonal/cyclical trends
-
- P. Primary target market size
 1. Number of prospective customers
 2. Total annual market
 3. Geographic areas
 4. Anticipated market growth
 - Q. Market penetration - how much, how, and why
 1. Market share
 2. Number of customers
 3. Geographic coverage
 4. Rationale for market penetration estimates
 - R. Pricing/gross margin targets
 1. Price levels
 2. Gross margin levels
 3. Discount structure (volume, early pay, etc.)
 - S. How to identify specific markets
 1. Directories
 2. Trade association directories
 3. Government documents
 - T. Media to be used to reach target market
 1. Publications
 2. Radio/TV
 3. Direct Mail
 4. Internet
 5. Endorsements
 6. Sources of influence and advice
 - U. Purchasing cycle of potential customers
 1. Needs identification
 2. Research of solution to needs
 3. Solution evaluation process
 4. Final solution responsibility and authority (executives, purchasing, engineers, etc.)
 5. Key trends and anticipated changes in primary target markets
 - V. Secondary target markets and key attributes
 1. Needs analysis
 2. Demographics
 3. Significant future trends

- W. Market Test Results
 - 1. Potential customers contacted
 - 2. Information/demonstrations given to customers
 - 3. Reactions of potential customers
 - 4. Test groups' willingness to purchase products/services at various price levels
- X. Lead Times
- Y. Initial orders
- Z. Reorders
- AA. Volume purchases
- BB. Competition
 - 1. Identification (by product line or service and market segment)
 - a) Existing
 - b) Market share
 - c) Potential (how long will window be open?)
 - d) Direct
 - e) Indirect
 - 2. Strengths (competitive advantages)
 - a) Ability to satisfy customers needs
 - b) Market penetration
 - c) Track record and reputation
 - d) Staying power (financial resources)
 - e) Key personnel
 - 3. Weaknesses (competitive disadvantages)
 - a) Ability to satisfy customers needs
 - b) Market penetration
 - c) Track record and reputation
 - d) Staying power (financial resources)
 - e) Key personnel
 - f) Importance of your target market to competition
 - 4. Barriers to entry into the market
 - a) Cost
 - b) Time
 - c) Technology
 - d) Key Personnel
 - e) Customer inertia (brand loyalty, existing relationships, fear of change, etc.)
 - f) Existing patents and trademarks

- CC. Regulatory Restrictions
 - 1. Customer or governmental regulations
 - a) Methods to meet these requirements
 - b) Timing involved in meeting them
 - c) Cost to meet them
 - d) Anticipated change in regulatory requirements

6.5 Products and Services

- DD. Detailed Product/Service Description (from users' perspective)
 - 1. Specific benefits of product/service
 - 2. Ability to meet needs
 - 3. Competitive advantages
 - 4. Present stage (idea, prototype, small production runs, established, etc.)
- EE. Product or Service Life Cycle
 - 1. Current position in its life cycle
 - 2. Factors that might change the life cycle
 - 3. Lengthen it
 - 4. Shorten it
- FF. Copyrights, Patents and Trade Secrets
 - 1. Existing or pending
 - 2. Anticipated filings
 - 3. Key aspects that cannot be patented/copyrighted
 - 4. Existing legal agreements with owners and employees
 - 5. Non-disclosure agreements
 - 6. Non-compete agreements
- GG. Research and Development Activities
 - 1. In process and current status or progress on development
 - 2. Future activities with milestones (Gantt Chart)
 - 3. Anticipated results
 - a) New products or services
 - b) New generations of existing products
 - c) Complementary products/services
 - d) Replacement products/services
- HH. Research and Development by others in industry
 - 1. Direct competitors
 - 2. Indirect competitors
 - 3. Suppliers

4. Customers

6.6 Marketing and Sales Activities

- II. Overall Marketing Strategy
 - 1. Market Penetration Strategy
 - a) High Profitability
 - b) Significant Market Share
 - 2. Growth Strategy
 - a) Internal
 - b) Acquisition
 - c) Franchise
 - d) Horizontal (provide products to different users)
 - e) Vertical (provide products to different levels in the distribution chain)
 - 3. Distribution channels (include discount & profitability at each stage)
 - a) OEM's
 - b) Distributors
 - c) Retailers
 - d) Value Added Resellers
 - e) Franchisees
 - f) Licensees
 - g) International
 - 4. Communications
 - a) Promotions
 - b) Advertising
 - c) Public Relations
 - d) Personal Selling
 - e) Printed material (catalogues, brochures, etc.)
 - f) Fax on Demand
 - g) Internet User Groups, Bulletins, Web pages
 - h) 800 or 888 Number Broadcasts
 - i) Direct Mail
- JJ. Sales Strategies
 - 1. Sales Force
 - a) Internal vs. independent representatives
 - b) Person-to-Person or Telemarketing
 - c) Size and composition

- d) Recruitment and training
 - e) Compensation
-
- 2. Prospecting
 - a) Identifying prospects
 - b) Prioritizing prospects
 - c) Qualifying prospects
 - 3. Sales Activities
 - a) Number of sales calls made per period
 - b) Average number of sales calls per week
 - c) Average dollar size of sale
 - d) Average dollar size of sale per reorder

6.7 Operations

- KK. Production and Service Delivery Procedures
 - 1. Internal
 - 2. External (subcontractors)
- LL. Production/Service Delivery Capacity
 - 1. Internal
 - 2. External (subcontractors)
 - 3. Anticipated increases in capacity
 - a) Investment
 - b) New cost factors (direct & indirect)
 - c) Logistics (will expansion slow production?)
 - d) Timing
- MM. Operating Competitive Advantages
 - 1. Techniques
 - 2. Experience
 - 3. Economies of scale
 - 4. Lower direct costs
- NN. Suppliers
 - 1. Identify suppliers of critical elements of production (primary & secondary)
 - 2. Lead time requirements
 - 3. Evaluate risks of critical element shortages
 - 4. Describe existing and anticipated contractual relationships with suppliers

6.8 Management and Ownership

OO. Management Structure

1. Management staff organization chart
2. Narrative description of chart

PP. Key Managers (Resumes in Appendix)

1. Name
2. Position
3. Primary responsibilities and authority
4. Primary responsibilities and authority with previous employer
5. Unique skills and experiences that add to company
6. Compensation basis, levels and incentives

QQ. Planned Additions to the Management Staff

1. Position
2. Primary responsibilities and authority
3. Requisite skills and experience
4. Recruitment process
5. Timing of employment
6. Anticipated contribution to the company's success
7. Compensation basis, levels, and incentives

RR. Legal Structure of the Business

1. Corporation
 - a) C Corporation
 - b) S Corporation
 - c) Limited Liability Corporation
2. Partnership
 - a) General
 - b) Limited
 - c) Limited Liability Partnership
3. Proprietorship

SS. Owners

1. Names and Percentage ownership
2. Extent of involvement with the company
3. Forms of ownership
 - a) Common stock
 - b) Preferred stock
 - c) General partner

- d) Limited partner
 - e) Outstanding equity equivalents
 - f) Options
 - g) Warrants
 - h) Convertible debt
-
- 4. Common stock
 - a) Authorized
 - b) Issued
- TT. Board of Directors
- 1. Names
 - 2. Position on the board
 - 3. Extent of involvement in the company
 - 4. Background
 - 5. Contribution to the company's success
 - a) Historically
 - b) In the future
- UU. Professional Support
- 1. Legal
 - 2. Accounting
 - 3. Banking
 - 4. Consultants

6.9 Organization and Personnel

- VV. Complete Organizational Chart
- 1. Positions
 - 2. Reporting Relationships
 - 3. Narrative description of the chart
- WW. Brief Position Descriptions
- 1. Primary duties
 - 2. Recruitment and training
 - 3. Staffing levels
 - 4. Compensation
 - a) Method
 - b) Levels
- XX. Anticipated Human Resource Requirements
- 1. Organization chart

2. Staffing levels by position
3. Changes in compensation levels and or methods

6.10 Source and Application of Funds

YY. Current Funding Requirements

1. Amount
2. Timing

3. Type
 - a) Equity
 - b) Debt
 - c) Mezzanine
4. Terms

ZZ. Funding Requirements in the Next Five Years

1. Amount
2. Timing
3. Type
 - a) Equity
 - b) Debt
 - c) Mezzanine
4. Terms

AAA. Application of Funds

1. Capital expenditures
2. Working Capital
3. Debt retirement
4. Acquisitions

BBB. Impact of New Funds on Company's Financial Position

1. Dilution of Ownership
2. Change in leverage levels (debt/equity ratio)

CCC. Long Range Financial Strategies (liquidate investors financial positions)

1. Going public
2. Leveraged Buy-Out
3. Acquisition by another company
4. Debt service levels and timing
5. Liquidation of the venture

6.11 Financial Data

DDD. Historical Financial Data (past 3 to 5 years)

1. Annual Summaries
 - a) Income Statement
 - b) Balance Sheet
 - c) Cash flow statements
 - d) Footnotes and exceptions
 2. Level of CPA involvement
 - a) Audit
 - b) Review
 - c) Compilation
- EEE. Prospective Financial Data (next five years)
1. First Year by month or quarter
 - a) Income Statement
 - b) Balance Sheet
 - c) Cash flow statement
 - d) Capital expenditure budget
 2. Second through fifth year by quarter or year
 - a) Income Statement
 - b) Balance Sheet
 - c) Cash flow statement
 - d) Capital expenditure budget
 3. Summary of significant assumptions
 4. Type of prospective financial data
 - a) Forecast (management's best estimate)
 - b) Projection ("what if" scenarios)
 5. Level of CPA involvement
 - a) Assembly
 - b) Agreed upon procedures
 - c) Review
 - d) Examination
- FFF. Analysis
1. Historical financial statements
 - a) Common size analysis
 - b) Ratio analysis
 - c) Trend analysis with graphs
 2. Prospective financial statements
 - a) Common size analysis
 - b) Ratio analysis

- c) Trend analysis with graphs

6.12 Business Valuation Analysis

GGG. Type of Valuation

1. Asset Approaches: Book, Adjusted Book Value, Liquidation
2. Income Approaches: Capitalization of Earnings, Excess Earnings and Discounted Future Earnings
3. Market Approaches: Multiples of Value (Public or Private), Rules of Thumb

4. Venture Capital Methods: First Chicago Method
5. Composite or Weighted Average

HHH. Timing and Reasons for Valuation

1. Pre Investment Analysis
2. Post Investment Analysis

III. Other Assumptions

1. Exit Strategies
2. Dilution Effects
3. Multiple Classes of Stock (if used)
4. Control Premiums and Discounts
5. Tax Consequences
6. Buy-Sell Agreements
7. Effect of Options and Warrants

6.13 Investment Proposal

JJJ. Introduction

1. Primary Objective
2. Parties and Relationships

KKK. Investment Proposal

1. Cash Return to Investors and ROI
2. Limitation of Investors' Liability

LLL. Investor Control Over Management

1. Strict Limitations on Company Spending
2. Investor Rights

MMM. Overseas Investor Attractiveness

NNN. Gauging Performance

1. Future Investment Opportunities
2. Investment Timing

OOO. Dealing with Risk

1. Ownership Percentages

2. Sufficiency of Investment
3. Development Risks
4. Currency Fluctuations
5. Reliance on Management
6. Transferability of Units
7. Catastrophic Loss
8. No Assurance of Profit or Return on Investment

6.14 Appendices and Exhibits.

- A. Resumes of Key Managers and Professional References
- B. Pictures of Products or Sample Service Brochures
- C. Government Licenses and Permits
- D. Market Studies, Company's and Third Party Findings
- E. Pertinent Published Information
 1. Magazine articles
 2. References to Books
- F. Patents, Copyrights, Trademarks, Trade names, Service Marks, Logos
- G. Significant Contracts
 1. Equipment or Land Leases
 2. Sales, purchase and vendor contracts
- H. Corporate Management Agreements
 1. Partnership/ownership agreements
 2. Stock Option agreements
 3. Employment/compensation agreements
 4. Non-compete agreements
- I. Insurance
 1. Product and general liability
 2. Officers' and directors' liability
- J. Other Significant Material Facts
 1. Pending Lawsuits
 2. Pending Real Estate transactions
 3. Pending tax rulings or accounting changes

7 BUSINESS VALUATION METHODS

There are seven methods to value a business generally approved. The First Chicago Method is typically used to value venture type businesses by Venture Capital firms.

7.1 Why value a business?

- Business Expansion
- Private Placements
- ESOP's
- Public Offerings
- Stock Options
- Warrants
- When buying or selling business
- Life Insurance
- Estate Planning
- Estate Tax and Gift Taxes
- Bankruptcy
- Payment of estate taxes
- Divorce settlements
- Probate
- Buy/Sell Agreements
- Stock re capitalization
- Shareholder disputes

7.1.1 Information required

- Balance Sheets
- Income Statements
- Cash Flow Statements
- Earnings Projections
- Business Comparable if available
- All data for maximum number of years possible

7.1.2 Determine the Scope of Valuation

- Size and complexity of the business
- Purpose of the valuation
- Depth of Due Diligence required
- Current stage of business development
- Asset and Sales size of the business
- Legal, tax and accounting requirements
- Timing of results and trend analysis
- Real Estate values determined separately

7.1.3 Data Gathering Process

- Premise inspections
- Review ownership and equity structure
- Review contingent liabilities, options and warrants
- Make replacement and liquidation adjustments
- Review local, regional and national competitors
- Review debt structure
- Review basis for book value
- Review financial statements and tax returns
- Assemble national and industry comparisons

7.1.4 Valuation Process

- Data Compilation
- Completion of Valuation Checklist
- Valuation analysis
- Comparable company analysis
- Proof of Valuation
- Valuation review with client company
- Final analysis input
- Performance review for payback
- Valuation summary prepared
- Final valuation report

7.2 Summary of Business Valuation Methods

7.2.1 1. Adjusted Net Assets

- Adjusts balance sheet for current and liquidation conditions
- Use Balance Sheet Values Given, Book Value and Market Value
- Formula: Business Value = Total Assets - Total Liabilities
- Requires knowledge of adjustments between book and market values

7.2.2 2. Capitalization of Earnings

- Puts a capital value on current adjusted earnings
- Formula: Value = Weighted Ave. Adjusted After Tax Earnings x Weighted Ave of P/E Ratio
- Data Required: Past Five years profits
- P/E ratio of 5 comparable public companies (note that P/E multiplier is the inverse of the capitalization rate) P/E = 8 Cap rate = 12.5%
- Adjustments are to correct for unearned income, write off, excessive compensation, etc.

7.2.3 3. Dividend Paying Capacity

- Measures ability of company to pay dividends after all adjusted expenses
- Formula: Value = Dividend Paying Capacity / Weighted Average Dividend Yield Rate
- Dividend Capacity = Weighted Average Adjusted Profit After Tax x Weighted Average Dividend Pay out Percentage
- Sub work sheets apply to methods 2, 4, 5

7.2.4 4. Excess Earnings:

- Return on Assets (measures earnings in excess of industry standards and adds goodwill value)
- Formulas: Excess Earnings = Weighted Average Profit After Tax - Industry Calculated Return on Assets
- Goodwill = Excess Earnings / Capitalization Rate
- Value = Goodwill + Adjusted Net Assets
- Data used: Five year historical
- Multiple Risk factors possible, High, Medium, Low
- Sub work sheet for Weighted Average After Tax apply to methods 2, 3, 5

7.2.5 5. *Excess Earnings: Return on Sales*

- Measures earnings in excess of industry standards and adds goodwill value
- Formula: $\text{Excess Earnings} = \text{Weighted Average After Tax} - \text{Industry Calculated Return on Sales}$
- $\text{Goodwill} = \text{Excess Earnings} / \text{Capitalization Rate}$
- $\text{Value} = \text{Goodwill} + \text{Adjusted Net Assets}$
- Data used: Five year historical
- Multiple Risk factors possible, High, Medium, Low
- Sub work sheet for Weighted Average After Tax apply to methods 2, 3, 4
- Capitalization rates developed from cost of borrowing, other factors

7.2.6 6. *Discounted Cash Flow*

- Measures the future value of cash flow at the industry standard discount rate
- Required Discount Rate Data: determines the value of the business by calculating the Present Value of the projected cash flows. Consider borrowing costs, expected return by investors and risks involved.
- $\text{Cash Flow} = \text{Net profit after tax plus non-cash expenses (depreciation)} - \text{non-deductible cash outlays}$. Forecast for 10 years if possible.
- Terminal Value: Determine the value of the business at the end of the forecast and then determine the present value of that amount.
- Base all data on projections and pro-formas.
- Use business plan.
- Use industry comparable.

7.2.7 7. *Discounted Future Earnings*

- Measures the future value of earnings at the industry standard discount rate
- Data Required: Discount Rates: determines the value of the business by calculating the Present Value of the projected earnings. Consider borrowing costs, expected return by investors and risks involved.
- Earnings are the ten year forecast of net profits after taxes from the pro forma
- Terminal Value: Determine the value of the business at the end of the forecast and then determine the present value of that amount.
- Base all data on projections and pro-formas.

- Use business plan.

- Use industry comparable.

7.2.8 8. *Combination Method*

- Allows use of all 6 methods and a weighting method to average all options.
- All weights must total 100% on the final total; otherwise you are giving a premium or a discount to the overall average value that will not be accurate.
- Control and Minority Discounts and Investment Payback can also be calculated based on industry comparable.
 - Premiums (+) given for controlling interest
 - Discounts (-) given for small minority interest

7.3 Valuations for Venture Capital and Startup Business Plans

- **Conventional Method:** This evaluates the expected case scenario for a venture based on its business plan. See the attached spreadsheet for these two methods.
- **First Chicago Method:** High-risk ventures are usually valued using the First Chicago Method that evaluates probabilities of success (IPO), the sideways scenario, and the failure scenario (liquidation). This method uses a high, risk-adjusted discount rate and embodies many assumptions. We specialize, however in the First Chicago Method as a means of determining the pre and post investment values for entrepreneurial (pre IPO) business investments.

7.4 Valuation Calculation Tables

Following are some valuation calculation tools that show the relationships between Present Values, Discount Factors, Cash Returns and Rates of Return on Investment. Use these tables in conjunction with the typical valuation spread sheet on the next page.

Valuation Calculations								
Present Value of a Dollar Earned at a Future Point in Time								
	<u>Discount Factors</u>							
<u>Period</u>	<u>25%</u>	<u>30%</u>	<u>35%</u>	<u>40%</u>	<u>45%</u>	<u>50%</u>	<u>55%</u>	<u>60%</u>
2 yrs	0.641	0.592	0.549	0.510	0.476	0.444	0.417	0.391
3 yrs	0.513	0.455	0.407	0.364	0.328	0.296	0.269	0.244
4 yrs	0.410	0.350	0.301	0.260	0.226	0.197	0.173	0.153
5 yrs	0.328	0.270	0.223	0.186	0.156	0.132	0.112	0.095
6 yrs	0.262	0.207	0.165	0.133	0.108	0.088	0.072	0.093
7 yrs	0.210	0.159	0.122	0.095	0.072	0.059	0.047	0.037
8 yrs	0.168	0.123	0.091	0.068	0.051	0.039	0.030	0.023
9 yrs	0.134	0.094	0.067	0.048	0.035	0.026	0.019	0.015

Cash Returns, Investment Periods & Rates of Return							
	<u>Investment Period</u>						
<u>Return</u>	<u>2 yrs</u>	<u>3 yrs</u>	<u>4 yrs</u>	<u>5 yrs</u>	<u>6 yrs</u>	<u>7 yrs</u>	<u>8 yrs</u>
2 X	41.4%	26.0%	18.9%	14.9%	12.2%	10.4%	9.1%
3 X	73.2%	44.2%	31.6%	24.6%	20.1%	17.0%	14.7%
4 X	100.0%	58.7%	41.4%	32.0%	26.0%	21.9%	18.9%
5 X	123.6%	71.0%	49.5%	38.0%	30.8%	25.8%	22.3%
6 X	144.9%	81.7%	56.5%	43.1%	34.8%	29.2%	25.1%
7 X	164.6%	91.3%	62.7%	47.6%	38.3%	32.0%	27.5%
8 X	182.9%	100.0%	68.2%	51.6%	41.4%	34.6%	29.7%
9 X	200.0%	108.0%	73.2%	55.2%	44.2%	36.9%	31.6%
10 X	216.2%	115.4%	77.8%	58.5%	46.8%	38.9%	33.4%
11 X	231.7%	122.4%	82.1%	61.5%	49.1%	40.9%	35.0%
12 X	246.4%	128.9%	86.1%	64.4%	51.3%	42.6%	36.4%

Use of these tables will help you better understand the statement, "we need a 10 times return over 5 years".

7.5 Conventional Valuation Example

For the Conventional Valuation Method you may plug in various user Inputs to determine the amount of equity you must sell in order to meet the requirements of the investor with respect to the required annual rate of return and expected discount factor.

By using several different scenarios with assigned probabilities, you can evolve a composite valuation that is similar to the First Chicago Method. To use a First Chicago Method, you would need to value one scenario at liquidation, and another at the IPO value, while holding the third to a 15% annual ROI.

Conventional Valuation with Variations				
Worksheet	Notes	Expected Case	Best Case	Worst Case
Base Year Revenue	User Input	\$ 240,000	\$ 500,000	\$ 500,000
Annual Growth Rate (%)	User Input	20%	40%	10%
Ending Year Revenue	Calculated	\$ 1,440,000	\$ 3,500,000	\$ 2,750,000
Years to Harvest	User Input	5	5	5
Target Years Revenues	Calculated	\$ 1,440,000	\$ 3,500,000	\$ 2,750,000
Projected After Tax Profit (%)	User Input	30%	50%	10%
Target Years After Tax Profit	Calculated	\$ 432,000	\$ 1,750,000	\$ 275,000
Price/Earnings Multiple	User Input	12	12	12
Future Value of Venture	Calculated	\$ 5,184,000	\$ 21,000,000	\$ 3,300,000
Required Annual Rate of Return (%)	Lookup	51.6%	51.6%	51.6%
Present Value Factor	Lookup	0.132	0.132	0.132
Discounted Present Value	Calculated	\$ 684,288	\$ 2,772,000	\$ 435,600
Required Equity Investment	User Input	\$ 250,000	\$ 250,000	\$ 250,000
Ownership Equity Sold/Purchased	Calculated	36.53%	9.02%	57.39%
Probability Assessment by Case		40%	10%	50%
Requested Percentage of Ownership based on weighted average of probabilities	Calculated	44%		

This example uses an 8 x return in 5 years, the Present Value factor for 5 years and 50% ROI

8 FINANCIAL RATIO ANALYSIS

8.1 General Information

Ratios are indicators not absolutes. Ratios can provide you with important information to help you better understand and more effectively plan business decisions. But understanding financial statements is more than just reviewing ratios. You must also thoroughly understand the business you are reviewing. When evaluating a ratio, be sure to evaluate the formula and the basic components and the derivation of the components.

It is recommended that the user is familiar with the basics of general accounting procedures and the principles involved in the preparation of financial statements. Not all financial statements are alike, and definitions may vary. Be certain that you understand what is being compared. Also keep in mind the reliability with which the financial statements were prepared. Is the data from audited financials or merely prepared from general accounting records, and is the company on a cash or accrual basis?

Also the value system used to value real estate, equipment, depreciation methods, and inventory valuations can cause wide variations in the accuracy and value of the analysis being performed. Factors such as whether to expense or capitalize assets, company size, age and industry will also need to be addressed in order to get an accurate picture of the ratios analyzed.

Long term versus short-term analysis can also be misleading. There are times when management, investors and others may concentrate on short-term implications to the detriment of long term performance. For long-term performance analysis, you may want to carefully review asset sales, expense cuts, compensation of officers, acquisitions and divestitures.

Industries averages and comparable are just that, averages. They do not represent any one single company. While they may give a good indication of overall industry performance, many factors such as age of company, new products, and marketing programs, local tax perks, and regional differences must all be accounted for. Closely held companies vary from public companies, and subsidiaries are different from stand-alone companies

Year to year trend analysis can be very useful. Evaluating historical information helps you determine trends by year and short term versus long term. This also helps you smooth out year-to-year anomalies based on write off and other exceptional adjustments.

An excellent source of information is available through Robert Morse & Associates (RMA), and is based on Standard Industry Classification Codes (SIC Codes). Others include Merrill Lynch's MergStat Review, a review of all mergers and acquisitions for the previous five years, and Ibbotsons' Stock, Bonds and Business Information SBBI analysis. You can

also call your stockbroker or commercial lender, who usually has all of these resources available.

Be sure to differentiate your business by manufacturing, wholesale, retail or service types.

8.2 Financial Statement Index

The following ratios will be based on formulas derived from having your financial information in the order outlined and numbered as shown. It is recommended that you then consult industry guides for the type of industry that your business most closely resembles.

<u>BALANCE SHEET</u>		
1. Cash	43. Cost of Goods Sold	82. Interest (paid)
2. Marketable Securities	44. Gross Profit	83. Income taxes (paid)
3. Notes Receivable	45. Selling Expense	84.
4. Accounts Receivable	46. Development Expense	85. Other Cash
5. Inventory	47. General & Admin	Received
6. Prepaid Expenses	48. Other Expense	86. Cash Change -
7. Total Current Assets	49. Operating Income	Operating
8.	50. Interest Income	87.
9. Long Term Investments	51. Other Income	88. Property Sales
10. Other Assets	52. Interest Expense	89. Property
11.	53. Other Expense	(purchases)
12. Land	54. Income Operations	90. Cash from
13. Property Plant & Equipment	55.	Investment Trades
14. Accumulated Depreciation	56. Taxes	91. Investment
15. Net Fixed Assets	57. Net Income -	(purchases)
16.	Operations	92. Collections on
17. Intangible Assets	58.	Loans
18.	59. Discount Segment	93.
19. Total Assets	income/(loss)	94. Other Cash
20. Notes Payable Short Term	60. Gain/(loss)	Received
21. Accounts Payable	Discount Segment	95. Cash Change -
22. Accrued Liabilities	61. Extraordinary	Investing
23. Taxes Payable	Gain/(Loss)	96.
24. Other Current Liabilities	62. Net Income	97. Proceeds from Debt
25. Total Current Liabilities	63.	(Bonds)
26.	64. Preferred Stock	98. Debt (repayments)
27. Notes Payable Long Term	Dividends	99. Dividend
28. Other Long Term Liabilities	65. Earnings for	(payments)
29. Total Liabilities	Common Stock	100. Common Stock
30.	66.	Issued
31. Preferred Stock	67. Common Stock	101. Treasury Stock
32. Common Stock	Dividends	(purchased)
33. Added Paid In Capital	68. Reinvested	102.
34. Treasury (stock)	Earnings	105. Other Cash
35. Retained Earnings	<u>CASH FLOW</u>	Received
36. Total Owners Equity	<u>STATEMENT</u>	106. Cash Change -
37.	78. Cash from	Financing
38. Total Liabilities & Equity	Customers	107.
<u>INCOME STATEMENT</u>	79. Cash (paid) to	108.
39.	Suppliers	Increase/(Decrease)
40. Gross Sales	80. Cash (paid) to	Cash & Equivalents
41. Returns & Allowances	employees	109.
42. Net Sales	81. Interest Received	

110. Cash & Equivalents at Beginning of Period	115. # Days Ratios (360 or 365)	120. Average Accounts Receivable
111. Cash & Equivalents at End of Period	116. Weighted Average of Common Shares	121. Average Inventory
112.	117. Stock Equivalents	122. Tax Rate, Fed & State
113. Total Cash Inflows	118. Market Value Common Shares	123. Depreciation Expense
114. Total Cash Outflows	119. Net Credit Sales	124. Preferred Shares
<u>SUPPLEMENTAL INFORMATION</u>		125. Market Value Preferred Shares

8.3 Liquidity Ratios

Liquidity is important to any company and measures the company's ability to convert assets to cash quickly and without significant loss. Liquidity ratios typically identify cash problems in the near term.

CURRENT RATIO #7 / #25

Test of a company's ability to pay current liabilities with current assets. Generally, a high ratio is good. To fully understand the current ratio, you need to evaluate the value of inventory and accounts receivable.

QUICK RATIO (#1 + #2 + #3 + #4) / #25

Also known as the acid test ratio. The current ratio with inventory and prepaid expenses removed. A strict test of a company's ability to pay current liabilities with current assets. Generally, a high ratio is good.

CASH/ASSET (#1 + #2) / #25

Also known as the cash ratio. Cash and marketable securities divided by current liabilities. If this ratio is low, converting accounts receivable and inventory into cash quickly is important.

ACCOUNTS RECEIVABLE IN DAYS (ENDING A/R AND NET SALES) #4 / (#42 / #115)

Accounts receivable turnover ratio expressed in days. Use of ending accounts receivable display day's sales not collected. Evaluate the ratio based on sales terms. If the ratio is significantly greater than the terms generally granted, there may be a problem. Look for un-collectable accounts or slow paying customers.

INVENTORY TURNOVER (USING ENDING INVENTORY) #43 / #5

The number of times inventory is used per period. Generally, a high value is good. A low value may mean obsolete inventory on hand or overstocking. If obsolete inventory needs to be written down, expenses will increase and assets, equity, and income will decrease. This may significantly affect other ratios.

OPERATING CYCLE (#4 / (#42 / #115)) + (#5 / (#43 / #115))

General estimate of the time it takes to purchase (or build) inventories, sell inventory, and collect cash. Generally, a short operating cycle is good. A long cycle indicates that

operating monies are tied up for a long period of time. If this ratio is increasing, evaluate the causes. Inventory or accounts receivable problems are likely to be the reason.

WORKING CAPITAL #7 - #25

Current assets minus current liabilities. Generally, working capital is considered money available for use in operations. Evaluate the value of inventory and accounts receivable to determine the value of working capital. Generally, significant working capital is good.

INVENTORY / WORKING CAPITAL #5 / (#7 - #25)

General indicator of the dependency working capital has on inventory. If working capital is dependent on inventory, it is important to know inventory is being sold quickly.

ACCOUNTS RECEIVABLE IN DAYS (AVERAGE A/R AND CREDIT SALES) #120 / (#119 / #115)

Accounts receivable turnover ratio expressed in days. Use of average accounts receivable displays the average number of days it takes to collect accounts receivable. Evaluate the ratio based on sales terms. If the ratio is significantly greater than the terms generally granted, there may be a problem. Look for un-collectible accounts or slow paying customers.

ACCOUNTS RECEIVABLE IN DAYS (AVERAGE A/R AND NET SALES) #120 / (#42 / #115)

Accounts receivable turnover ratio expressed in days. Use of average accounts receivable displays the average number of days it takes to collect accounts receivable. Evaluate the ratio based on sales terms. If the ratio is significantly greater than the terms generally granted, there may be a problem. Look for un-collectible accounts or slow paying customers.

ACCOUNTS RECEIVABLE TO CURRENT LIABILITIES #4 / #25

General indicator of sufficiency of accounts receivable for bill paying. High ratio may be good for liquidity purposes, but a high ratio may also mean accounts receivable are not being collected quickly or that significant terms are being extended. A low ratio may indicate excessive current liabilities.

ACCOUNTS RECEIVABLE TO WORKING CAPITAL #4 / (#7 - #25)

General indicator of the dependency working capital has on account receivable. If working capital is dependent on account receivable, it is important to know account receivables are being collected in a timely manner. If this ratio is high, be sure to evaluate account receivable in days and accounts receivable turnover.

ACCOUNTS RECEIVABLE TURNOVER (CREDIT SALES/AVERAGE A/R) #119 / #120

Indicates how often average account receivable is collected per period in relation to credit sales. Generally, a high ratio is good. A high ratio means accounts receivable are being collected in a timely manner. If this ratio is decreasing, accounts receivable collections may have slowed down. Evaluate the cause.

ACCOUNTS RECEIVABLE TURNOVER (CREDIT SALES/ENDING A/R) #119 / #4

Indicates how often ending accounts receivable is collected per period in relation to credit sales. Generally, a high ratio is good. A high ratio means the ending accounts receivable balance is low in relation to credit sales. If this ratio is decreasing, evaluate the cause.

ACCOUNTS RECEIVABLE TURNOVER (NET SALES/AVERAGE A/R) #42 / #120

Indicates how often average accounts receivable is collected per period in relation to net sales. Generally, a high ratio is good. A high ratio means accounts receivable are being collected in a timely manner. If this ratio is decreasing, accounts receivable collections may have slowed down. Evaluate the cause.

ACCOUNTS RECEIVABLE TURNOVER (NET SALES/ENDING A/R) #42 / #4

Indicates how often ending accounts receivable is collected per period in relation to net sales. Generally, a high ratio is good. A high ratio means the ending accounts receivable balance is low in relation to net sales. If this ratio is decreasing, evaluate the cause.

ACCOUNTS RECEIVABLE IN DAYS (ENDING A/R AND CREDIT SALES) #4 / (#119 / #115)

Accounts receivable turnover ratio expressed in days. Use of ending accounts receivable display day's sales not collected. Evaluate the ratio based on sales terms. If the ratio is significantly greater than the terms generally granted, there may be a problem. Look for un-collectible accounts or slow paying customers.

CURRENT DEBT/EQUITY #25 / #36

A general indicator of borrowing potential. A low ratio is good. A low ratio means investors have made a greater commitment to the company. A low ratio tends to mean collateral is available for loans

DAYS INVENTORY (USING AVERAGE INVENTORY) #121 / (#43 / #115)

Inventory turnover ratio expressed in days. When average inventory is used, days inventory is an estimate of the average number of days it takes to sell inventory based on average cost of goods sold. Generally, a low ratio is good. A high ratio may indicate excessive inventory or "slow" sales. Evaluate carefully increases in this ratio.

DAYS INVENTORY (USING ENDING INVENTORY) #5 / (#43 / #115)

Inventory turnover ratio expressed in days. When ending inventory is used, days inventory is an estimate of how much inventory is on hand in terms of average cost of goods sold. Generally, a low ratio is best. A high ratio may indicate excessive inventory or "slow" sales. Evaluate carefully increases in this ratio.

INVENTORY TURNOVER (USING AVERAGE INVENTORY) #43 / #121

The number of times inventory is used per period. Generally, a high value is good. A low value may mean obsolete inventory on hand or overstocking. If obsolete inventory needs to be written down, expenses will increase and assets, equity, and income will decrease. This may significantly affect other ratios.

8.4 Cash Flow Ratios

Cash flow is often more important than income, since paying current liabilities is often more important than immediate profits. Cash flow ratios are also liquidity ratios but are derived from the cash flow statement rather than the income statement. Income reflects depreciation, amortization, inventory as used, and sales as recorded (not necessarily as collected). Income does not reflect cash outflows for inventory when purchased, capital expenditures when made, and more. Cash is used to run the business; income reveals how well the business is run.

OPERATING CASH / NET INCOME FROM OPERATIONS #86 / #57

A general estimate of cash generated by income. A value over 1.0 indicates income understates cash generation related to income. In the short-term, if liquidity problems exist, a value over 1.0 is good. In the long run, this ratio should average close to 1.0.

OPERATING CASH / NET SALES #86 / #42

A General estimate of cash generated by sales. Generally, a high ratio is good.

CASH FLOW / REINVESTED EARNINGS #108 / #68

Change in cash and cash equivalents divided by reinvested earnings. In general, the ratio displays whether earnings left in the business support cash increases. If the ratio is less than 1.0, reinvested earnings are supporting cash flow. A very low ratio may indicate a potential near-term liquidity problem

DAILY OPERATING CASH #86 / #115

Average cash increase or decrease per day as a result of operating activities. Cash increases or decreases related to operating activities as defined by the cash flow statement. High daily operating cash is important for bill paying and working capital growth.

DAILY NON-OPERATING CASH (#95 + #106) / #115

Average cash increase or decrease per day as a result of investing and financing activities. Cash increases or decreases related to "non-operating" activities as defined by the cash flow statement.

CURRENT LIABILITIES MINUS CASH, OPERATING CASH TURNOVER IN DAYS (#25 - #111) / (#86 / #115)

The average number of days it takes to generate sufficient cash to pay existing current liabilities that cannot be paid with existing cash. A low ratio is good. If this ratio is high, it may mean liquidity problems. If this ratio is higher than average accounts payable terms, bills may be paid late.

WORKING CAPITAL OPERATING CASH TURNOVER IN DAYS (#7 - #25) / (#86 / #115)

A general indicator of how long it takes to convert working capital into cash. Generally, a low value is good. A low ratio could also mean little working capital however. Generally, significant working capital is good

CASH EQUIVALENT CASH TURNOVER (USING ENDING CASH & EQUIVALENTS) #86 / #111

Operating cash divided by ending cash and cash equivalents. In general, an indicator of how often the company replenishes cash and cash equivalents with operating cash. Generally, a high ratio is good. It means the company is converting operating "income" or "sales" into cash quickly. The amount and importance of immediate cash affect the importance of this ratio.

WORKING CAPITAL OPERATING CASH TURNOVER #86 / (#7 - #25)

A general indicator of how often working capital is replaced by operating cash. Generally, a high ratio is good. A high ratio communicates good liquidity. A high ratio could be generated with low working capital however. Evaluate working capital.

8.5 Profitability Ratios

Also known as efficiency or activity ratios, they illustrate how profitable a company is and typically assessed how well the company uses money to generate sales and income. Profitability ratios use assets and capital that has been invested for a long period prior to the year you are analyzing.

These ratios can be significantly affected by age of company, prior performance, initial equity and more. Discounting and premiums must be used, as well as average balances rather than beginning or year-end balance sheet numbers. In these calculations, year-end balances are used which already include the past years gains and losses since most of these ratios will be used to predict future performance.

RETURN ON ASSETS (USING ENDING ASSETS & NET INCOME) #57 / #19

A general indicator of how well assets was used to generate income. Also, a general indicator of the rate of return earned on assets

RETURN ON CAPITAL (USING YEAR-END CAPITAL & BEFORE TAX INCOME) #54 / (#27 + #28 + #36)

A general indicator of how well capital was used to generate income. Also, a general indicator of the rate of return earned on capital. For comparing companies, using before tax income eliminates the effects of tax differences.

RETURN ON EQUITY (USING YEAR-END EQUITY & NET INCOME) #57 / #36

A general indicator of how well equity was used to generate income. Also, a general indicator of the rate of return shareholders' earned on their investment in the company

SALES / TOTAL ASSETS (USING YEAR-END TOTAL ASSETS) #42 / #19

A measure of how well total assets was used to generate sales. Generally, a high ratio is good. If the ratio is very high, evaluate the value of assets. Increases in this ratio are usually good. Evaluate comparable and trends.

SALES / INVESTED CAPITAL (USING YEAR-END CAPITAL) #42 / (#27 + #28 + #36)

A measure of how well invested capital was used to generate sales. Generally, a high ratio is good. Evaluate comparable and trends.

SALES / EQUITY (USING YEAR-END EQUITY) #42 / #36

A measure of how well stockholder investments was used to generate sales. Generally, a high ratio is good. Evaluate comparable and trends.

SALES / WORKING CAPITAL (USING YEAR-END WORKING CAPITAL) #42 / (#7 - #25)

A measure of how well working capital was used to generate sales. Generally, a high ratio is good. Evaluate comparable and trends.

SALES / FIXED ASSETS (USING YEAR-END NET FIXED ASSETS) #42 / #15

A measure of how well fixed assets was used to generate sales. Generally, a high ratio is good. If the ratio is very high, evaluate the value of fixed assets. Evaluate comparable and trends.

8.6 Other Profitability Ratios

RETURN ON ASSETS (USING ENDING ASSETS & ADJUSTING FOR INTEREST) (#57 - (#52 * (1 - #122))) / #19

A general indicator of how well assets was used to generate income. Also, a general indicator of the rate of return earned on assets. For comparing companies, that adding back interest expense eliminated the effects of differing levels of debt. By adding back interest, "operating" performance can be evaluated

RETURN ON ASSETS (USING ENDING ASSETS & BEFORE TAX INCOME) #54 / #19

A general indicator of how well assets was used to generate income. Also, a general indicator of the rate of return earned on assets. For comparing companies, using before tax income eliminates the effects of tax differences

RETURN ON COMMON EQUITY (YEAR-END EQUITY & ADJUST. FOR INTEREST) ((#57 - #64) - (#52 * (1 - #122))) / (#32 + #33 + #34 + #35)

A general indicator of how well common equity was used to generate income. Also, a general indicator of the rate of return common shareholders' earned on their investment in the company. For comparing companies, that adding back interest expense eliminated the effects of differing levels of debt. By adding back interest, "operating" performance can be evaluated.

RETURN ON EQUITY (USING YEAR-END EQUITY AND BEFORE TAX INCOME) #54 / #36

A general indicator of how well equity was used to generate income. Also, a general indicator of the rate of return shareholders' earned on their investment in the company. For comparing companies, using before tax income eliminates the effects of tax differences

RETURN ON CAPITAL (YEAR-END CAPITAL & ADJUSTING FOR INTEREST)

(#57 - (#52 * (1 - #122))) / (#27 + #28 + #36)

A general indicator of how well capital was used to generate income. Also, a general indicator of the rate of return earned on capital. For comparing companies, that adding back interest expense eliminated the effects of differing levels of debt. By adding back interest, "operating" performance can be evaluated.

RETURN ON CAPITAL (USING YEAR-END CAPITAL & NET INCOME) #57 / (#27 + #28 + #36)

A general indicator of how well capital was used to generate income. Also, a general indicator of the rate of return earned on capital.

RETURN ON EQUITY (USING YEAR-END EQUITY & ADJUSTING FOR INTEREST) (#57 - (#52 * (1 - #122))) / #36

A general indicator of how well equity was used to generate income. Also, a general indicator of the rate of return shareholders' earned on their investment in the company. For comparing companies, that adding back interest expense eliminated the effects of differing levels of debt. By adding back interest, "operating" performance can be evaluated.

RETURN ON EQUITY (USING YEAR-END EQUITY AND BEFORE TAX INCOME) #54 / #36

A general indicator of how well equity was used to generate income. Also, a general indicator of the rate of return shareholders' earned on their investment in the company. For comparing companies, using before tax income eliminates the effects of tax differences.

SALES / CURRENT ASSETS (USING YEAR-END CURRENT ASSETS) #42 / #7

A measure of how well current assets was used to generate sales. Generally, a high ratio is good. Evaluate comparable and trends.

SALES / CURRENT LIABILITIES #42 / #25

A general indicator of the sufficiency of sales to pay existing current liabilities. A high ratio is good. A high ratio communicates high sales or low current liabilities. A low ratio may communicate slow payments to creditors.

SALES / INVENTORY (USING YEAR-END INVENTORY) #42 / #5

Also known as inventory turnover. A measure of how well inventory was used to generate sales. Generally, a high ratio is good. If this ratio is going down, look for excessive inventory, slow moving inventory, or sales slow downs. (Be careful not to confuse this ratio with cost of goods sold to inventory - also known as inventory turnover.)

8.7 Solvency Ratios

Solvency ratios indicate a company's ability to pay long-term obligations. The company's ability to pay interest on borrowed funds, pay dividends to preferred stockholders, to collateralize loans and to pay off creditors should a dissolution occur.

DEBT / EQUITY #29 / #36

An indicator of debt in relation to equity. The higher the ratio, the greater the investment by creditors in relation to shareholders. A high ratio may mean new debt will be difficult to obtain

LONG-TERM LIABILITIES / WORKING CAPITAL (#27 + #28) / (#7 - #25)

A general indicator of a future burden on working capital. A high ratio communicates significant working capital will be used to pay off long-term debt. If the ratio is high, evaluate when long-term debt is due.

TIMES INTEREST EARNED (#54 - #52) / (-#52)

Income before taxes plus interest expense divided by interest expense. A general indicator of the "cushion" available for paying interest expense. A high ratio is good. A low ratio may indicate liquidity or solvency problems. A low ratio may indicate too much debt or too little profit.

DEGREE OF FINANCIAL LEVERAGE (#54 - #52) / #54

An indicator of the impact of debt on earnings for shareholders. The higher the ratio, the greater the debt and the greater the opportunity for shareholders if income goes up. A high ratio also communicates risk. The more the ratio exceeds 1.0, the greater the risk for creditors should income go down.

FIXED ASSETS / CAPITAL #15 / (#27 + #28 + #36)

An indicator of how much of all capital is invested in fixed assets. If the ratio is high, the company may have too much money invested in fixed assets. A high ratio may mean working capital is reduced.

FIXED ASSETS / LONG-TERM DEBT #15 / (#27 + #28)

A general indicator of the use of long-term debt. A value of less than 1.0 indicates long-term debt was used to finance working capital or other assets. A low value generally indicates a lack of collateral for loans.

BOOK VALUE #36 - #31

Also known as net worth. Total equity less preferred stock equity. Generally, a high value indicates a large investment in the company by common shareholders. For obtaining loans, a high value is usually good. Book value is often considered a general estimate of the minimum "worth" of a company. Generally, increases in this ratio are good.

PREFERRED DIVIDEND COVERAGE #62 / #64

For shareholders and others, an indicator of income available to pay preferred dividends as a multiple of preferred dividends. Generally, a high ratio is good

LONG-TERM DEBT / CAPITAL (#27 + #28) / (#27 + #28 + #36)

An indicator of the percentage of total capital that came from long-term debt. Generally, the higher the ratio, the higher the risk for lenders. If the ratio is high, securing additional debt may be difficult.

8.8 Investor Ratios

Also known as Market Ratios, these additional ratios are important to investors and more specifically stockholders. All previous ratios of liquidity, solvency, cash flow, and profitability

reflect various aspects of the investor's position and security. These ratios generally deal with earnings and disbursement to common stockholders.

SIMPLE EARNINGS PER SHARE #65 / #116

Earnings available to common shareholders divided by average shares outstanding. General indicator of income per share available for dividends.

PRICE / EARNINGS #118 / (#65 / #116)

Price per common share of stock divided by simple earnings per share. An estimate of how investors perceive the company. If the price/earnings ratio is high, investors believe the company will have significant increases in earnings and/or significant growth. A high price/earnings ratio may create pressure on management to keep earnings high.

DIVIDEND PAYOUT #67 / #65

Dividends paid as a percent of earnings before dividends. If this ratio is high, evaluate the impact of substantial withdrawals of income from the company. If dividend disbursement percents follow stock prices more than earnings, evaluate the effect. Generally, dividends should relate closely to earnings but not necessarily stock prices.

RETAINED EARNINGS #68 / #65

An indicator of the earnings left with the company for future growth. For growth oriented companies, this ratio should be high. For "cash cows" this ratio may be low. Evaluate trends and the company's prospects for growth to understand the significance of this ratio.

DIVIDENDS PER SHARE #67 / #116

Evaluate dividends per share in relation to the dividend disbursement ratio and the dividend yield ratio. Watch for trends. Increases in the dividend disbursement ratio to maintain a constant or growing dividend yield ratio should be evaluated for long-term implications.

DIVIDEND PAYOUT #67 / #65

Dividends paid as a percent of earnings before dividends. If this ratio is high, evaluate the impact of substantial withdrawals of income from the company. If dividend disbursement percents follow stock prices more than earnings, evaluate the effect. Generally, dividends should relate closely to earnings but not necessarily stock prices.

CASH FLOW PER SHARE #108 / #116

Change in cash and cash equivalents divided by common shares outstanding. Cash flow per share is an indicator of how much cash per share is available for dividends. Generally, a high ratio is good.

BOOK VALUE PER SHARE (#36 - #31) / # 116

Common equity divided by average shares outstanding. An estimate of each stockholder's investment in the company. Often considered the "minimum" value of each share of stock

DIVIDEND YIELD (#67 / #116) / #118

Rates of return based on dividends declared and the market value of common stock. Watch for trends. Compare trends with dividend disbursement trends.

DILUTION #117 / #116

A potential decrease in a shareholder's percent of stock ownership because of stock options, warrants, convertible debt, etc. If this ratio is high, as a stockholder, your future dividends, ownership, and stock appreciation may be reduced significantly.

8.9 Additional Ratios

Some ratios are industry specific, such as sales per square foot for retailers, sales per employee, etc. These ratios may be calculated and added to your analysis as requested.

CURRENT LIABILITIES IN DAYS (BASED ON NET SALES) #115 / (#42 / #25)

An estimate of how large current liabilities is based on net sales. Generally, a low ratio is good. A high ratio may mean a liquidity problem and slow payments to creditors.

INVENTORY / CURRENT LIABILITIES #5 / #25

Indicator of the importance of inventory for paying debt. If inventory turnover is quick, a high ratio is good. This ratio is also an indicator of the value of inventory. A high ratio may indicate excessive inventory or Over-valued inventory. A low ratio may indicate excessive current liabilities.

CURRENT DEBT / WORKING CAPITAL #25 / (#7 - #25)

Indicator of the sufficiency of working capital. Generally, a low ratio is good. A high ratio indicates high current debt or low working capital. If the ratio is high, inventory and accounts receivable analyses are important to determine whether the company has or will have a liquidity problem.

CURRENT ASSET OPERATING CASH TURNOVER #86 / #7

An indicator of how often current assets are replaced with operating cash. Generally, a high ratio is good. It means current assets are being converted into cash often.

POTENTIAL SALES GROWTH (USES YEAR-END BALANCES) ((#42 / #19) * (#68 + (#68 * #29 / #36))) / #42

Sales growth expected if earnings for the year plus additional debt equivalent to the existing debt/equity ratio are reinvested in the company and the reinvestment generates

sales equal to the existing sales/assets ratio. A high ratio is generally good, but a high ratio can also communicate increasing inventories, accounts receivable, and current liabilities.

DEPRECIATION / PROPERTY, PLANT & EQUIPMENT #123 / #13

An estimate of depreciation for the year as a percent of gross property, plant, and equipment. A high ratio indicates a significant reduction in income because of depreciation. This should have a positive impact on cash flow. A low ratio may signify old fixed assets and upcoming capital expenditures. Evaluate comparable and trends.

8.10 Financial Performance Viewpoints

A. Management's Viewpoint

1. Operational Ratios
 - a. Gross Margin
 - b. Profit Margin
 - c. Operating Expenses
 - d. Profit Contribution of products
 - e. Asset Management
 - f. Asset Turnover
 - g. Working Capital
 - h. Inventory Turnover
 - i. Accounts Receivable
 - j. Accounts Payable
2. Profitability
 - a. Return on Assets
 - b. Earnings Before Interest and Taxes (EBIT)
 - c. Return on Assets

B. Owners' Viewpoint

1. Profitability
 - a. Return on Net Worth
 - b. Return on Common Equity
 - c. Earning per Share
2. Disposition of Earnings
 - a. Cash Flow per Share
 - b. Dividends per Share
 - c. Dividend Yield
 - d. Payout to Retained Earnings Ratio
 - e. Dividend Coverage
3. Market Indicators
 - a. Price to Earnings Ratio
 - b. Market to Book Value Ratio
 - c. Z Score

C. Lender's Viewpoint

1. Liquidity
 - a. Current Ratio
 - b. Acid Test Ratio
2. Leverage
 - a. Debt to Assets
 - b. Debt to Capitalization
 - c. Debt to Equity
3. Debt Service
 - a. Interest Coverage
 - b. Principal and Interest Coverage

BUSINESS FITNESS QUIZ

9.1 Financial

	True	False
9.1.1 Liquidity:		
1. Have collection agencies threatened to file suit?	3	0
2.* Have tax liens been filed against the firm?	3	0
3. You never use the float to solve cash flow.	0	1
4. The controller never spends > 2 hours per week with vendors who want to be paid?	0	1
5.* We are current on all "Withholding and state taxes".	0	3
6. Average collection period is less than 50% of time for cash discounts.	0	2
7. All accounts payable are being serviced on agreed terms. We are not behind.	0	3
8. Financial statements are prepared monthly for review.	0	2
9.* Inventory procedures allow us to have an accurate inventory on a monthly basis.	0	2
10.* Accounts receivable on financial statements is accurate, and our customers can actually pay the amount listed and agree with the amount.	0	3
11. Cash in the bank account reflects the accurate balance of actual funds available after all checks have been written and mailed.	0	3
12. The accounts payable balance reflected includes all invoices presented, including those that we dispute.	0	3

9.1.2 Growth, Profitability and Control Systems

13. Unit sales volume is decreasing?	1	0
14. The company has reported a pretax profit for the last two years.	0	1
15. Sales, G&A as a percentage of sales are increasing?	3	0
16. The gross profit margin of core products has increased over last year.	0	1
17. Major decisions about new directions for products, markets, etc. reflect a clear strategy.	0	2
18. The turnover rate of inventory has improved over last year.	0	1
19. The company has a business plan that clearly defines the next year's goals.	0	2
20.* The company uses a budget and constantly updates it	0	2

against the business plan.

	0	3
21.* The company's sales force projects sales, and there is consistency with the inventory and personnel loading in the budget.		
22. The company has a program to quantitatively measure customer satisfaction.	0	2
23. Individual responsibilities for monitoring and achieving goals are clearly defined.	0	1

9.1.3 *Management: Is it Multiplying or Dividing your business equation?*

The CEO's Leadership

24. Our company has a well defined written mission statement.	0	2
25. The CEO frequently interacts with the employees at all levels of the company.	0	2
26. Employees are well informed of the company's current status.	0	1
27.* Our company lacks the resources to expand or meet its present goals.	3	0
28. Major decisions such as re-capitalization, personnel changes, etc. have a formal approval process.	0	1
29. A single individual has responsibility for the company's day-to-day operating decisions.	0	3

9.1.4 *Key Managers*

30. Education, experience, loyalty, motivation and competence qualify all managers who report to me.	2	0
31. The turnover in management staff has been greater than 20% per year.	2	0
32. There are employees being carried for non-economic reasons such as family, longevity, emotional or other reasons.	2	0
33. I do not believe that the performance of the firm could be improved by replacing any of the key managers.	0	1

9.1.5 *The Management and Board of Directors Relationship*

34. The BOD is independent of the Operational Officers and knowledgeable in the industry.	0	2
35. There is lack of mutual trust and respect between some officers and the Board.	3	0
36. All the Directors come to the Board meeting prepared with constructive ideas.	0	2
37. The owners or major stockholders who work actively in the business complement each other and communicate openly.	0	3
38. The Board of Directors meetings or management meetings are productive and pointed toward growth not blame, and	0	3

timely decisions are made and implemented.

9.1.6 Over-diversification, Over-leverage, Over-expansion

39. The key managers carry out their duties in a normal workweek and rarely have to work overtime or weekends.	0	1
40. The key areas of the business are adequately staffed for normal operations.	0	2
41. The ratio of the company's total debt to equity increased over the past year.	2	0
42. Debt service (interest plus principal) as a percentage of gross profit has increased from last year's figures.	2	0

9.2 External Factors

9.2.1 Banking Relationships

43. The bank frequently notifies us that our account is overdrawn.	3	0
44.* We are current on our interest payments and meet our loan agreement.	0	3
45. Our banker is friendly and cooperative and eager to assist us in any way.	0	3
46. Our banker calls frequently to inquire about the status of our loan and ask very tough questions.	2	0
47. Our banker has inquired about our willingness to pledge additional collateral.	3	0

9.2.2 Legal Affairs

48. Except for collections from our delinquent payments, there is no other litigation against the company.	0	1
49.* Where there is a lawsuit and the company is a defendant, the company could pay the judgment and continue to operate with little or no effect.	0	3
50. If the company is involved in a lawsuit that will benefit the company, the minimum expected recovery would cover the maximum expected legal cost.	0	2
51. The CEO spends more than 10% of his time on legal matters.	1	0

9.2.3 Single Customer- Single Vendor Dependence

52. More than 35% of the company's receivables or inventory come from one customer.	3	0
53.* In the event that the company should lose a major customer to a competitor, the company could be reorganized so that profitability is not affected.	0	3

- | | | |
|--|---|---|
| 54. In the event that the company's major customer filed for bankruptcy, the resulting restructuring and write-offs would not affect the company's current banking relationships or terms of the loan. | 0 | 3 |
| 55. In the event that any of the company's major suppliers or support services went out of business, they could be easily replaced in a timely manner. | 0 | 3 |
| 56. All the company's existing suppliers are providing materials on schedule and of the quality necessary to sustain profitability. | 0 | 1 |

9.2.4 Changes in the Market, Technology, and Environment

- | | | |
|---|---|---|
| 57. The market for the company's product or service is quite soft, and prices must be cut frequently to maintain market share. | 3 | 0 |
| 58. Our company is among the top four firms (in terms of market share) for the markets we serve. | 0 | 1 |
| 59. Our pricing policy is tied to the dominant firm in our industry and we follow that lead. | 1 | 0 |
| 60. We have, in the ordinary course of business, been able to replace products and services that competition and technology have made obsolete. | 0 | 2 |

Total your Test Scores and pay particular attention to the asterisked (*) questions. These questions were designed to identify life-threatening conditions to a company. Accumulating any points on these questions indicates the business is experiencing very serious problems.

Totals	Your Score	Asterisked Questions
Financial (1 through 23)		
Management (24 through 42)		
External Factors (43 through 60)		
Total Score		

Level One: Scores 0 - 20 points with no points in asterisked questions: The company is operating effectively.

Level Two: Scores 20 - 50 with any points on asterisked questions. Your firm is vulnerable and immediate corrective action is called for to prevent a downward spiral. If you could deal with your problems internally you would have done so. Seek outside assistance.

Level Three: Scores above 51 **Emergency.** Personal Equity or Loan Guarantors are in jeopardy and the business is in serious condition with multiple problems. **Take Immediate Action!**

9.3 Z Score

The Z Score was developed after many years of analyzing companies and their financial dynamics. This formula takes into account the income and expense, balance sheet and cash flow statements. You may also use the index key from the report on financial ratio analysis for these formulas.

9.3.1 Z Score - Private Company

$$(0.717 \times ((\text{Total Current Assets} - \text{Total Current Liabilities})/\text{Total Assets}) + (0.847 \times (\text{Retained Earnings}/\text{Total Assets})) + (3.107 \times ((\text{Income from Operations} - \text{Interest Expense})/\text{Total Assets}) + (0.42 \times (\text{Total Owners Equity}/\text{Total Liabilities})) + (0.998 \times (\text{Net Sales}/\text{Total Assets}))$$

Based on actual bankruptcy statistics, private companies with a score below 1.23 have an increased chance of bankruptcy. Companies with scores between 1.23 and 2.90 are "questionable." Companies with scores over 2.90 are "healthy." Evaluate carefully the implications of this ratio.

9.3.2 Z Score - Public Company

$$(1.2 \times ((\text{Total Current Assets} - \text{Total Current Liabilities})/\text{Total Assets}) + (1.4 \times (\text{Retained Earnings}/\text{Total Assets})) + (3.3 \times ((\text{Income from Operations} - \text{Interest Expense})/\text{Total Assets}) + (0.60 \times (((\text{Weighted Average of Common Shares} \times \text{Market Value of Common Shares}) + (\text{Preferred Shares} \times \text{Market Value of Preferred Shares}))/\text{Total Liabilities})) + (0.999 \times (\text{Net Sales}/\text{Total Assets}))$$

Based on actual bankruptcy statistics, public companies with a score below 1.81 have an increased chance of bankruptcy. Companies with scores between 1.81 and 2.99 are "questionable." Companies with scores over 2.99 are "healthy." Evaluate carefully the implications of this ratio.

10 ABOUT GLOBAL MILLENNIA MARKETING

Global Millennia Marketing Inc. is one of the first of a new breed of integrated Internet marketing communications companies and is comprised of four on-line divisions. Our ability to work closely at all levels optimizes synergy between the different divisions from the strategic planning stage right through to tactical execution of all our projects.



John Shenton B.Eng., President of Global Millennia Marketing, is a dynamic, adaptable and results driven Senior Executive with many years experience in building and operating companies in N. America & Europe, creating market presence and increasing sales throughout domestic and International markets worldwide.

His strong technical and analytical background is supported by comprehensive sales, marketing, operational, and general management skills in the computer, Internet and telecommunication industry.

He has a great deal of International experience, having lived and worked within the United Kingdom, Germany, Switzerland and Canada.

defined goals and expectations.

Operations are controlled from Montreal, Canada.

From here we are able to provide service on a global basis in English, French, Chinese and Arabic to a diverse range of companies from start-up to established corporations.

As the use of New Digital Media such as the Internet, CD-ROM's, DVD's, increases, the importance of coordinating its use with traditional printed media becomes paramount. We are uniquely placed to address this need, having evolved from genuine specialists in both fields.

We work with our clients to develop effective, long-term partnerships, which encompass every facet of the management and marketing functions, from initial project consulting through creative design and production, to corporate presentation management.

Our teams have many years' industrial experience in the fields of Sales & Marketing, Finance and Information Technology in North America, Europe and Asia. This background allows us to quickly empathize with our clients to understand their markets, their objectives and to identify their business needs.

Through strategic planning and the creative application of our skills and experience, we deliver effective total marketing communications solutions, which meet, and typically exceed, their pre-

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