Valued Representation

VR is celebrating 32 years of successful business sales through valued representation. Valued Representation defines VR.
VR is: VALUED REPRESENTATION

Welcome to Volume #6 Course # 1

“RECASTING AN INCOME STATEMENT”
ANALYZING AND RECASTING

WHAT YOU WILL LEARN...

➢ In this section you will learn why we recast an income statement
➢ You will learn to differentiate between different earning levels
➢ You will review several types of IRS Income tax forms
➢ Learn how to recast an income statement.
ANALYZING AND RECASTING

Course Objectives

Prepare a business to be valued by:

- Understanding why and how to recast an income statement.
- Understanding why and how to recast a balance sheet.

(This is not a valuation course.)
ANALYZING AND RECASTING

Volume 6 Course 1
Recasting an Income Statement
ANALYZING AND RECASTING

Recasting an Income Statement

- In this section you will learn why we recast an income statement
- You will learn to differentiate between different earning levels
- You will review several types of IRS Income tax forms
- Finally, you will learn how to recast an income statement.
Why Recast?

Also known as “Normalizing or Adjusting”

- Seller’s Objective: Minimize taxes by writing off all expenses possible including:
  - discretionary expenses
  - one-time expenses
  - non-cash expenses.

- Not all expenses may apply to the Buyer and there may even be new expenses for the Buyer that the Seller does not have.

- Buyer’s Objective: Determine all potential earnings available to him and real value of assets being transferred.
ANALYZING AND RECASTING

Differentiating Between Different Earnings Levels

- **Net income**: Earnings after all expenses (including tax)
- **EBT**: Earnings Before Taxes
- **EBIT**: Earnings Before Interest and Taxes
- **EBITDA**: Earnings Before Interest, Taxes, Depreciation, and Amortization
- **Seller’s Discretionary Earnings (SDE) (aka SDC, DE or Owner’s Benefit)**: Adjusted earnings before taxes, interest, depreciation and other non-cash charges, and prior to deducting the compensation for one full-time owner or officer.
ANALYZING AND RECASTING

SDE vs. EBITDA

- **SDE = Owner Operated:**
  - SDE is all adjusted income possible for one full-time owner operator (including the owner salary).
  - Thus, it is usually used in valuing Main Street businesses where the buyer is buying a job.

- **EBITDA = help run:**
  - EBITDA is all adjusted income possible help run.
  - Thus it is often used when valuing Mergers and Acquisitions.
  - The acquiring company needs to know what the adjusted income would be if run by management instead of owner operated.
A Personal Story

Business had SDE of $200,000.
   Associate valued business at 2-2.5 times this figure.
   Accountant said 4-5 times earnings.

Associate pointed out that the accountant looks at EBITDA not SDE, because they want to know earnings from an investment standpoint not from an owner operator.

Since it would cost $100,000 to put in full-time owner, EBITDA would be $100,000 compared to the SDE of $200,000.

Thus, 4-5 times EBITDA is the same as 2-2.5 times SDE in this case.

Both Associate and Accountant put the same value on the business.
ANALYZING AND RECASTING

Types of Financial Statements

➢ Tax Returns
  ✓ Best source
  ✓ Most institutional lenders require 3 years.

➢ Interim financial statement prepared by accountant
  ✓ Good source for up to date numbers, especially on the balance sheet.

➢ Seller’s personal logs
  ✓ Not dependable and not recognized by most lenders.
ANALYZING AND RECASTING

Income Statement vs. Balance Sheet

➢ Whether using a tax return or a financial statement the document should contain:
  ✓ An income statement, usually referred to as a Profit and Loss Statement or P&L
  ✓ A balance sheet, used to detail the assets and liabilities of the company at the specific time of the statement.

➢ Both sections are necessary when valuing businesses.
Types of Tax Returns

- Depending on the type of ownership there are several types of tax returns.
- A good associate not only must be familiar with all types, they should be able to tell what type of ownership the business has by looking at the form.
ANALYZING AND RECASTING

Form 1040

- Also known as Schedule C
- Is used with Sole Proprietorships
<table>
<thead>
<tr>
<th>Part I</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Gross receipts or sales. Enter your Form W-2 and the &quot;Adjusted Gross Income&quot; box on that form. See page C-2 and check here.</td>
</tr>
<tr>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>7</td>
<td>Gross income. Add lines 1 through 6.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part II</th>
<th>Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>Advertising</td>
</tr>
<tr>
<td>9</td>
<td>18 Office expense</td>
</tr>
<tr>
<td>10</td>
<td>Commissions and fees</td>
</tr>
<tr>
<td>11</td>
<td>19 Pension and profit-sharing plans</td>
</tr>
<tr>
<td>12</td>
<td>20 Rent or lease (see page C-6)</td>
</tr>
<tr>
<td>13</td>
<td>21a Medical, dental, and hospital expenses</td>
</tr>
<tr>
<td>14</td>
<td>21b Other business property</td>
</tr>
<tr>
<td>15</td>
<td>22 Supplies (not included in Part III)</td>
</tr>
<tr>
<td>16</td>
<td>23 Taxes and licenses</td>
</tr>
<tr>
<td>17</td>
<td>24 Travel, meals, and entertainment</td>
</tr>
<tr>
<td>18</td>
<td>24a Travel</td>
</tr>
<tr>
<td>19</td>
<td>24b Lodging and entertainment (see page C-6)</td>
</tr>
<tr>
<td>20</td>
<td>25a Utilities</td>
</tr>
<tr>
<td>21</td>
<td>26 Wage/Tip (see employment credit)</td>
</tr>
<tr>
<td>22</td>
<td>27a Other expenses (not included in Part II) (see page C-6)</td>
</tr>
<tr>
<td>23</td>
<td>27b Other expenses (see page C-8)</td>
</tr>
<tr>
<td>24</td>
<td>27c Other expenses (not included in Part II) (see page C-6)</td>
</tr>
<tr>
<td>25</td>
<td>27d Other expenses (see page C-8)</td>
</tr>
<tr>
<td>26</td>
<td>27e Other expenses (see page C-8)</td>
</tr>
<tr>
<td>27</td>
<td>27f Other expenses (see page C-8)</td>
</tr>
<tr>
<td>28</td>
<td>Total expenses. Add lines 17 through 27 in columns.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part III</th>
<th>Net Profit or Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>29</td>
<td>Tentative profit (loss). Subtract line 28 from line 7.</td>
</tr>
<tr>
<td>30</td>
<td>Expenses for business use of your home. Attach Form 8829.</td>
</tr>
<tr>
<td>31</td>
<td>Net profit or loss. Subtract line 30 from line 29.</td>
</tr>
</tbody>
</table>

For Paperwork Reduction Act Notice, see page C-2 of the instructions.
ANALYZING AND RECASTING

Form 1065

Used with:
• Partnerships
• Limited Liability Companies (LLC’s)
• Limited Liability Partnerships (LLP’s)
# U.S. Return of Partnership Income

**Form 1065**

**Department of the Treasury**  
**Internal Revenue Service**

**For calendar year 2006, or tax year beginning** ………………… 2006, ending ………………… 20……

**See separate instructions.**

**D (Employer identification number)**

**E (Date business started)**

**F (Total assets (see the instructions))**

<table>
<thead>
<tr>
<th>G Check applicable boxes:</th>
<th>( ) Initial return</th>
<th>( ) Final return</th>
<th>( ) Name change</th>
<th>( ) Address change</th>
<th>( ) Amended return</th>
</tr>
</thead>
<tbody>
<tr>
<td>H Check accounting method:</td>
<td>( ) Cash</td>
<td>( ) Accrual</td>
<td>( ) Other (specify)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**I Number of Schedules K-1: Attach one for each person who was a partner at any time during the tax year.**

---

**Caution.** Includes only trade or business income and expenses on lines 1 through 22. See the instructions for more information.

**Income**

1a Gross receipts or sales  
1b Less returns and allowances  
1c  

2 Cost of goods sold (Schedule A, line 8)  
3 Gross profit. Subtract line 2 from line 1c  
4  

5 Ordinary income (loss) from other partnerships, estates, and trusts (attach statement)  
6 Net farm profit (loss) (attach Schedule F (Form 1060))  
7 Other income (loss) (attach statement)  
8 Total income (loss). Combine lines 3 through 7  

9 Salaries and wages (other than to partners) (less employment credits)  
10 Guaranteed payments to partners  
11 Repairs and maintenance  
12 Bad debts  
13 Rent  
14 Taxes and licenses  
15 Interest  
16a Depreciation (if required, attach Form 4562)  
16b Lease depreciation reported on Schedule A and elsewhere on return  
16c  
17 Depletion (Do not deduct oil and gas depletion.)  
18 Retirement plans, etc.  
19 Employee benefit programs  
20 Other deductions (attach statement)  
21 Total deductions. Add the amounts shown in the far right column for lines 9 through 20  

22 Ordinary business income (loss). Subtract line 21 from line 8

---

**Sign Here**

**Preparer’s signature**  
**Preparer’s use only**

**Paid Preparer’s Use Only**

**For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.**

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ANALYZING AND RECASTING

Form 1120

- Used with Corporations (C-Corps)
  - Considered a stand-alone legal entity
  - This type of Corporation is taxed directly on any profits it earns prior to dispersing dividends to its shareholders.
**U.S. Corporation Income Tax Return**

**Form 1120**

For calendar year 2010 or tax year beginning _________, ending _________.

**Income**

1. Gross receipts or sales
2. Cost of goods sold (Schedule A, line 1)
3. Gross profit. Subtract line 2 from line 1
4. Dividends (Schedule C, line 16)
5. Interest
6. Gross rents
7. Gross royalties
8. Capital gain net income (attach Schedule D (Form 1120)).
9. Net gain or (loss) from Form 4797, Part I, line 17 (attach Form 4797)
10. Other income (gas instructions - attach schedule)
11. Total income. Add lines 5 through 10

**Deductions**

12. Compensation of officers (Schedule E, line 4)
13. Sales and exchanges (less employment credits)
14. Repairs and maintenance
15. Bad debts
16. Rents
17. Taxes and licenses
18. Interest
19. Charitable contributions
20. Depreciation from Form 4562 not claimed on Schedule A or elsewhere on return (attach Form 4562)
21. depletion
22. Advertising
23. Fines, profit-sharing, etc., plans
24. Employee benefit programs
25. Domestic production activities deduction (attach Schedule 800)
26. Other deductions (attach schedule)
27. Total deductions. Add lines 15 through 26
28. Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11
29. Less: a. Net operating loss deduction (see instructions)
   b. Special deductions (Schedule C, line 29)
30. Taxable income. Subtract line 29 from line 28 (see instructions)

**Tax and Payments**

31. Total tax (Schedule J, line 10)
32a. 2008 overpayment credited to 2007
32b. 2007 estimated tax payments
   a. First payment applied for on Form 4845
   b. Second payment applied for on Form 4845
   c. Tax deducted with Form 7004
   d. Other (explain)
33. Estimated tax penalty (see instructions). Check if Form 2220 is attached
34. Amount owing. If the tax is smaller than the total of lines 31 and 32, enter amount owed
35. Overpayment. If the tax is larger than the total of lines 51 and 54, enter amount overpaid
36. Enter amount from line 34 you want credited to 2008 estimated tax
37. Refund claimed

**Sign Here**

Signatures of officer
Name
Title
Date

**Paid Preparer’s Use Only**

Preparer’s signature
Preparer’s EIN or SSN
Firm’s name or your name if self-employed
Address, city, state, and ZIP code
Phone no.

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ANALYZING AND RECASTING

Form 1120S

Used by subchapter S corporations.

- There are no corporate taxes paid on income of this type of corporation.
- The profits of the company essentially pass through to the shareholders who are taxed as individuals.
## U.S. Income Tax Return for an S Corporation

**Form 1120S**

For calendar year 2005, or tax year beginning [Year], ending [Year]

**Effective date of return**

1. **Name:** [Name]
2. **Employer Identification Number:** [Number]
3. **Date Incorporated:** [Date]
4. **Total Assets (See instructions):** [Amount]

**Business name and address information**

- **Name:** [Name]
- **Address:** [Address]
- **City, State, and ZIP Code:** [City, State, ZIP Code]

**Check applicable boxes:**
- [ ] Initial return
- [ ] Final return
- [ ] Name change
- [ ] Address change
- [ ] Amended return
- [ ] Enter number of shareholders in the corporation at the end of the tax year.

**Caution:** Include only trade or business income and expenses on lines 1a through 21. See the instructions for more information.

### Income

1. **Self-employment income:** [Amount]
2. **Net gain (loss) from Form 4797, Part II, line 17 (attach Form 4797):** [Amount]
3. **Interest:** [Amount]
4. **Depreciation (attach Form 4562):** [Amount]
5. **Depletion (Do not deduct oil and gas depletions):** [Amount]
6. **Ordinary business income (loss):** [Amount]

### Deductions

1. **Self-employment tax:** [Amount]
2. **Interest:** [Amount]
3. **Depreciation claimed on Schedule A and elsewhere on return:** [Amount]
4. **Subtract line 4a from line 14:** [Amount]
5. **Depletion (Do not deduct oil and gas depletions):** [Amount]
6. **Ordinary business income (loss):** [Amount]

### Taxes and Payments

1. **Payments:** [Amount]
2. **Credit for Federal tax paid on fuels (attach Form 4798):** [Amount]
3. **Add lines 22a and 22b (see the instructions for additional taxes):** [Amount]
4. **Estimated tax penalty (see instructions). Check if Form 2220 is attached:** [Amount]
5. **Tax due:** [Amount]
6. **Overpayment:** [Amount]

### Sign Here

- **Signature of officer:** [Signature]
- **Title:** [Title]
- **Date:** [Date]

### Preparer's Information

- **Preparer's signature:** [Signature]
- **Preparer's SSN or PTIN:** [Number]
- **Preparer's firm's name (if self-employed):** [Name]
- **Preparer's phone number and ZIP code:** [Number]

**For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions.**

Cat. No. 11560H Form 1120S (2008)

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ANALYZING AND RECASTING

Interim Financial Statement…

- Usually done monthly or quarterly
- Can be produced at anytime
- A current financial statement is an important part of valuing a business.
- Contains up-to-date information
ANALYZING AND RECASTING

Common Fields of Tax Returns and Interim Financial Statements

- Sales
- Cost of goods
- Gross profit
- Operating expenses
- Net operating profit
- Other income/expenses
- Net profit before taxes
- Net profit after taxes
Recasting an Income Statement

In this section you will:
- Be introduced to our standard recast sheet.
- Recast an actual tax return in class
  - Learn what categories to adjust
  - Learn why we make those adjustments
ANALYZING AND RECASTING

When Recasting the Statement

➢ Look at the statement from a buyer’s perspective.
➢ Buyers want to know the real earning potential of the company.
➢ In addition to the net income of the business, you will need to make several adjustments to determine the discretionary earnings.
ANALYZING AND RECASTING

Standard Adjustments to the Income on the Financial Statement

- Pretax Profit
- Non-Cash Expenses
  - Depreciation
  - Amortization
- Interest (Do not add back interest for flooring.)
- Officer’s/Owner’s Salary
- Discretionary Items
  - Owner’s Auto
  - Owner’s Insurance
  - Travel
  - Meals & Entertainment
  - Payroll Taxes for Owner
  - Misc.
- Non-Recurring Expenses
- Expenses not on the P&L
ANALYZING AND RECASTING

The Standard Recast Sheet

- Use the following sheet starts with the to help guide you through the recast process.

- Remember:
  - Never mix statements.
  - Interview seller to determine all add backs.
  - Verify all add backs have actually been taken out of the statement you are recasting.
  - Be careful with adjustments. Keep in mind when representing the income to a buyer it is better to undersell and over deliver.
## SDE RECAST SHEET

<table>
<thead>
<tr>
<th>Name of Business:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Year/Period</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td></td>
</tr>
<tr>
<td>Cost of Sales</td>
<td></td>
</tr>
<tr>
<td>Payroll</td>
<td></td>
</tr>
<tr>
<td>Rent</td>
<td></td>
</tr>
<tr>
<td>Remaining Opt. Expenses</td>
<td></td>
</tr>
<tr>
<td>Operating Income/Pre-Tax Profit</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
</tr>
<tr>
<td>Amortization</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td></td>
</tr>
<tr>
<td>Officer’s/Owner’s Salary</td>
<td></td>
</tr>
<tr>
<td>Adjusted Income for SBA</td>
<td></td>
</tr>
</tbody>
</table>

### Discretionary Expenses (Define Miscellaneous)

| Auto for owner’s personal use |   |
| Insurance for owner’s personal use |   |
| Travel not required by business |   |
| Entertainment |   |
| Meals |   |
| Profit Sharing/Retirement for owner |   |
| Miscellaneous: |   |
| Miscellaneous: |   |
| Miscellaneous: |   |

### Non-Recurring Expenses (Define)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Expenses not included on P&L (To be subtracted from Earnings)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The undersigned hereby warrant(s): 1) He/They is/are the owner(s) of the business, 2) the above is a true representation of the discretionary earnings of the business, 3) the information is furnished to broker pursuant to the Representation/Listing Agreement between owner and broker, 3) broker is authorize to share with potential purchasers of the business, 4) Owner hereby indemnifies Broker for any liability arising from Broker’s use of this information. **All parties receiving this information are hereby notified that Broker has not made any investigation into the accuracy of the information contained on this sheet and those parties are to make their own independent investigation as to the accuracy of this information and to look solely to the Seller for any loses or damages caused by the inaccuracy of this information.**

Owner: Date:  Owner: Date:

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ANALYZING AND RECASTING

Sample Company Tax Return

➢ An actual tax return can be many pages.
➢ When recasting a tax return:
  ✓ Try to get the entire tax return
  ✓ You will need at least the first 4 pages plus any schedules that are referenced on those pages.
➢ Apply the SDE Recast sheet to the following tax return.
➢ A discussion of some of the highlighted lines follows each page.
The image contains a scanned copy of a U.S. Corporation Income Tax Return form. The form is filled out with various financial details and calculations. The form is for the tax year 2002 ending on 3/31/2003. The calculations include gross receipts or sales, cost of goods sold, gross profit, dividends, interest, and deductions such as depreciation and employee benefit programs. The total income and total deductions are shown, leading to a net income of $538,062. The form includes detailed sections for each item, with subtotals and explanations for each calculation.
ANALYZING AND RECASTING

Lines of Interest on Page 1

- Note the date of the return at the top.
  - Corporations usually run on a fiscal not a calendar year.
  - Even though the tax return is for 2002 in this case the year end was actually March 31, 2003.
- Line 1 Gross Receipts or Sales
- Line 2 Cost of Sales (see page 2 for details).
- Line 5 could actually be a deduction!
ANALYZING AND RECASTING

Lines of Interest Page 1 (continued)

- Line 12 Compensation of Officers is an add back.
  - Check page 2 of tax return and verify hours worked with seller

- Lines 18 and 19 are add backs
  - But be careful not to add back interest for flooring or other necessary financing.

- Line 21b:
  - We usually add back 100% of depreciation unless it was for items that need to be replace frequently like trucks or computers.
  - In this case the depreciation was split into two parts.
  - Do we add back only $13,528 or do we add it all back?
Line 24:
- Seller stated ½ profit-sharing was hers.

Line 25:
- Seller stated employee benefits includes company health insurance including $1000 per year for Seller.

Line 28:
- Taxable income is part of the Discretionary Earnings
### Schedule A: Cost of Goods Sold (see instructions)

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Inventory at beginning of year</td>
<td>1,474</td>
</tr>
<tr>
<td>2</td>
<td>Purchases</td>
<td>1,018,070</td>
</tr>
<tr>
<td>3</td>
<td>Cost of labor</td>
<td>204,603</td>
</tr>
<tr>
<td>4</td>
<td>Additional Section 280A costs (attach schedule)</td>
<td>See Statement 2</td>
</tr>
<tr>
<td>5</td>
<td>Other costs (attach schedule)</td>
<td>156,558</td>
</tr>
<tr>
<td>6</td>
<td>Total, Add lines 1 through 5</td>
<td>1,441,278</td>
</tr>
<tr>
<td>7</td>
<td>Inventory at end of year</td>
<td>48,550</td>
</tr>
<tr>
<td>8</td>
<td>Cost of goods sold, Subtract line 7 from line 6. Enter here and on line 2, page 1</td>
<td>1,392,728</td>
</tr>
</tbody>
</table>

**Note:** Check all methods used for valuing closing inventory:

- Cost as described in Regulations section 1.471-3
- Lower of cost or market as described in Regulations section 1.471-4
- Other (specify method used and attach explanation)

**Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970):**

**If property is produced or acquired for resale, do the rules of section 280A apply to the corporation?**

**Was there any change in determining quantities, cost, or valuations between opening and closing inventory?**

### Schedule C: Dividends and Special Deductions (see instructions)

<table>
<thead>
<tr>
<th></th>
<th>(a) Dividends received</th>
<th>(b) Percentage</th>
<th>(c) Special deductions (a) x (b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Dividends from less-than-20%-owned domestic corporations that are subject to the 70% deduction</td>
<td>70</td>
<td>0</td>
</tr>
<tr>
<td>2</td>
<td>Dividends from 20%-or-more-owned domestic corporations that are subject to the 30% deduction</td>
<td>80</td>
<td>see instr.</td>
</tr>
<tr>
<td>3</td>
<td>Dividends on debt-financed stock of domestic and foreign corporations (section 965A)</td>
<td>42</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>Dividends on certain preferred stock of less-than-20%-owned public utilities</td>
<td>48</td>
<td>0</td>
</tr>
<tr>
<td>5</td>
<td>Dividends on certain preferred stock of 20%-or-more-owned public utilities</td>
<td>70</td>
<td>0</td>
</tr>
<tr>
<td>6</td>
<td>Dividends from less-than-20%-owned foreign corporations and certain FSCs that are subject to the 70% deduction</td>
<td>80</td>
<td>0</td>
</tr>
<tr>
<td>7</td>
<td>Dividends from 20%-or-more-owned foreign corporations and certain FSCs that are subject to the 80% deduction</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>8</td>
<td>Dividends from wholly owned foreign subsidiaries subject to the 100% deduction (section 245A)</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>9</td>
<td>Total, Add lines 1 through 8. See instructions for limitation</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>10</td>
<td>Dividends from domestic corporations received by a small business investment company operating under the Small Business Investment Act of 1958</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>11</td>
<td>Dividends from certain FSCs that are subject to the 100% deduction (see 245C(c)(2))</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>12</td>
<td>Dividends from affiliated group members subject to the 100% deduction (section 245C(c)(2))</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>13</td>
<td>Other dividends from foreign corporations not included on lines 1, 6, 7, 8, or 11</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>14</td>
<td>Income from controlled foreign corporations under subpart F (attach Form 5471)</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>15</td>
<td>Foreign dividend gross-up (section 78)</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>16</td>
<td>IC-DISC and former DISC dividends not included on lines 1, 2, or 3 (section 246B)</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>17</td>
<td>Other dividends</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>18</td>
<td>Deduction for dividends paid on certain preferred stock of public utilities</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>19</td>
<td>Total dividends. Add lines 1 through 17. Enter here and on line 4, page 1</td>
<td>137,000</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>Total special deductions. Add lines 9, 10, 11, 12, and 18. Enter here and on line 29b, page 1</td>
<td>137,000</td>
<td></td>
</tr>
</tbody>
</table>

### Schedule E: Compensation of Officers (see instructions for line 12, page 1)

<p>| | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>(b)</td>
<td>(c)</td>
<td>(d)</td>
<td>(e)</td>
<td>(f)</td>
</tr>
<tr>
<td>Amount of compensation</td>
<td>Compensation of officers</td>
<td>Percent of time devoted to business</td>
<td>Percent of corporation stock owned</td>
<td>Common</td>
<td>Preferred</td>
</tr>
<tr>
<td>100</td>
<td>100</td>
<td>0.00</td>
<td>137,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Complete Schedule E only if total receipts (line 1a plus lines 4 through 10 on page 1) are $500,000 or more.

2 Total compensation of officers | 137,000 |
3 Compensation of officers claimed on Schedule A and elsewhere on return | 137,000 |
4 Subtract line 3 from line 2. Enter the result here and on line 12, page 1 | 137,000 |

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ANALYZING AND RECASTING

Lines of Interest on Page 2…

- Line 1, beginning inventory and Line 7, ending inventory can be used to determine inventory.
  - Verify with Seller it is right and count only good and sellable merchandise.)
  - If the actual inventory value is different you may need to adjust SDE Recast.
- Line 3 Cost of Labor
  - Many buyers like to see all labor listed separately and not as part of the cost of sales!
- Line 5 (Statement 2)
  - Be sure to pick get a copy of any statements and look for add backs.
- Schedule E Compensation to officers:
  - This is where you can verify who are the officers and what each one was paid. You still need to verify the total hours each officer worked!
ANALYZING AND RECASTING

Notes:

- Page 3 contains tax computation information and other information about the company including accounting methods but is not needed in our discussion here.
- Page 4 is the balance sheet of the company and will be discussed later in this class.
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auto and Truck</td>
<td>$12,849</td>
</tr>
<tr>
<td>Bank Charges</td>
<td>$522</td>
</tr>
<tr>
<td>Credit Card Discount</td>
<td>$1,693</td>
</tr>
<tr>
<td>Dues and Subscriptions</td>
<td>$364</td>
</tr>
<tr>
<td>Insurance</td>
<td>$33,690</td>
</tr>
<tr>
<td>Legal and Professional</td>
<td>$207</td>
</tr>
<tr>
<td>Meals and Entertainment</td>
<td>$1,248</td>
</tr>
<tr>
<td>Office Expense</td>
<td>$13,749</td>
</tr>
<tr>
<td>Outside Services</td>
<td>$2,776</td>
</tr>
<tr>
<td>Parking and Tolls</td>
<td>$6</td>
</tr>
<tr>
<td>Pension Administration</td>
<td>$1,200</td>
</tr>
<tr>
<td>Postage</td>
<td>$1,340</td>
</tr>
<tr>
<td>Sales Expense</td>
<td>$30,139</td>
</tr>
<tr>
<td>Security</td>
<td>$495</td>
</tr>
<tr>
<td>Telephone</td>
<td>$11,785</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$119,043</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auto &amp; Truck</td>
<td>$17,027</td>
</tr>
<tr>
<td>Depreciation</td>
<td>$24,009</td>
</tr>
<tr>
<td>Freight</td>
<td>$3,348</td>
</tr>
<tr>
<td>Job Travel</td>
<td>$4,018</td>
</tr>
<tr>
<td>Outside Services</td>
<td>$15,870</td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>$14,797</td>
</tr>
<tr>
<td>Rent</td>
<td>$49,586</td>
</tr>
<tr>
<td>Repairs and Maintenance</td>
<td>$381</td>
</tr>
<tr>
<td>Shop Supplies</td>
<td>$13,259</td>
</tr>
<tr>
<td>Uniforms</td>
<td>$5,934</td>
</tr>
<tr>
<td>Utilities</td>
<td>$1,319</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$157,558</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name</td>
</tr>
<tr>
<td>ID Number</td>
</tr>
<tr>
<td>Percentage Owned</td>
</tr>
</tbody>
</table>
Lines of Interest from Federal Statements Page 1

Statement 1:
- Auto and Truck: Owner stated only vehicle is her personal vehicle
- Insurance included her auto insurance of $2000 per year
- Meals and entertainment were add backs
Lines of Interest from Federal Statements Page 1 (Continued)

Statement 2

- **Auto expense was for owner’s personal vehicle**
- **Depreciation:**
  - Note some of the depreciation claimed on line 20 of the first page of the tax return was applied to the cost of sales...
  - But since it was taken out of the profit of the company you can add back the entire 37,537 on the recast sheet.
ANALYZING AND RECASTING

SELLER MUST VERIFY ADJUSTMENTS…

- Work with the Seller and Seller’s accountant to verify any adjustments.
- Have Seller sign recast sheet.
- Be sure Seller has signed financial statement &/or income tax forms.
- Never represent anything the seller won’t put in writing and sign.
Personal Story

One of my associates took a listing and put the seller’s tax return in the file. A business profile was made reflecting the income on the tax return. I made an appointment to show the business and at the appointment the buyer said to the seller “I understand you did X $ in sales last year.” The Seller said he had never done that much in his life.

Later I found out the tax returns were phony and had been constructed so the seller could get a loan. Associate had not checked to see if tax returns had been signed or verified they were real.
### SDE RECAST SHEET

**Name of Business:** Sample Company  
**Year/Period:** 2011

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Sales</td>
<td>1,998,292</td>
</tr>
<tr>
<td>2</td>
<td>Cost of Sales</td>
<td>1,376,128</td>
</tr>
<tr>
<td>3</td>
<td>Gross Profit</td>
<td>622,164</td>
</tr>
</tbody>
</table>
| 4 | Payroll | 157,040*  
*Some Payroll is in Cost of Sales |
| 5 | Rent | 49,586*  
*Rent is included in Cost of Sales |
| 6 | Total Operating Expenses | 522,351 |
| 7 | Operating Income/Pre-Tax Profit | 99,813 |
| 8 | Officer’s/Owner’s Salary | 137,000 |
| 9 | Depreciation & Amortization | 37,537*  
*Some Depreciation is in Cost of Sales |
| 10 | Interest | 640 |
| 11 | Adjusted Income for SBA | 274,990 |

#### Discretionary Expenses (Define Miscellaneous)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td>Auto for owner’s personal use</td>
</tr>
<tr>
<td>13</td>
<td>Insurance for owner’s personal use</td>
</tr>
<tr>
<td>14</td>
<td>Travel not required by business</td>
</tr>
<tr>
<td>15</td>
<td>Meals &amp;Entertainment</td>
</tr>
<tr>
<td>16</td>
<td>Charitable Deductions</td>
</tr>
<tr>
<td>17</td>
<td>Profit Sharing/Retirement for owner</td>
</tr>
<tr>
<td>18</td>
<td>Miscellaneous:</td>
</tr>
<tr>
<td>19</td>
<td>Miscellaneous:</td>
</tr>
<tr>
<td>20</td>
<td>Miscellaneous:</td>
</tr>
</tbody>
</table>

#### Non-Recurring Expenses (Define)

<p>| |</p>
<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>21</td>
</tr>
<tr>
<td>22</td>
</tr>
<tr>
<td>23</td>
</tr>
</tbody>
</table>

#### Expenses not included on P&L (To be subtracted from Earnings)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>24</td>
<td></td>
</tr>
<tr>
<td>25</td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>Total Adjustments</td>
</tr>
<tr>
<td>27</td>
<td>Seller’s Discretionary Earnings</td>
</tr>
</tbody>
</table>

---

The undersigned hereby warrant(s): 1) He/They is/are the owner(s) of the business, 2) the above is a true representation of the discretionary earnings of the business, 3) the information is furnished to broker pursuant to the Representation/Listing Agreement between owner and broker, 3) broker is authorized to share with potential purchasers of the business, 4) Owner hereby indemnifies Broker for any liability arising from Broker’s use of this information. All parties receiving this information are hereby notified that Broker has not investigated the accuracy of the information contained on this sheet and those parties are to make their own independent investigation as to the accuracy of this information and to look solely to the Seller for any losses or damages caused by the inaccuracy of this information.

___Jane Owner____________5/1/2012____

Owner:    Date:  Owner:    Date:
ANALYZING AND RECASTING

WHAT YOU HAVE LEARNED…

- Understand why we recast the income statement
- Know the difference between SDE and EBITDA.
- Recognize the various IRS forms
- Understand what fields comprise SDE
- Be able to recast an income statement
ANALYZING AND RECASTING

THINK POSITIVE
THINK BIG
THINK VALUED REPRESENTATION

VR HAS SOLD MORE BUSINESSES IN THE WORLD THAN ANYONE