

Pawnshop Consulting Group

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Valuation Principles

Good Afternoon!

I want to thank all of you who have attended our round table discussion in regards to valuations. Having an independent valuation can prove to be very useful for many reasons.

For those of you seeking to research the feasibility of possibly selling your operation, having a proper valuation conducted on your business may prove to be very worthwhile. There can be a number of ways that a potential acquiring group may choose to value your business and having your own independent market evaluation in many cases has PROVEN to be money in the bank.

We are once again seeing quite a resurgence for the marketability of qualified pawn operations in various markets. During these time periods as we have seen historically, market demand much like the price of gold can drive the valuation processes forward depending on how aggressively your business could be pursued by a potential acquiring entity.

There are a number of ways that we can go about the process of valuing your business and some of those would include the following:

Valuation Methodology

Introduction

The business valuation discipline recognizes various methodologies used to arrive at an estimate of fair market value. These methodologies are not mutually exclusive but are somewhat interrelated among three valuation approaches, namely, the market approach, the income approach, and the asset-based approach.

I have considered the factors set forth by the Internal Revenue Service's Revenue Ruling 59-60 in my general analysis of ANY potential target. Some of the factors considered in a typical valuation would include:

1. The nature of the business and the history of the enterprise from its inception
2. The economic outlook, in general, and the condition and outlook of the industry in particular
3. The book value of the equity and the financial condition of the business
4. The earning capacity of the business
5. Whether or not the enterprise has goodwill or other intangible value
6. The market price of businesses engaged in the same or a similar line of business having their equity traded in a free and open market

Market Approach

In the market approach, the value of a business enterprise is estimated through the analysis and comparison of similar entities or actual transactions that have occurred in the marketplace. Two basic methods under the market approach are the *guideline company method*, and the *transaction method*. Under the guideline company method, an indication of value is developed from the analysis of minority interest transactions in shares of publicly traded companies considered similar to the subject company. Under the transaction method, transfers of ownership interests in private companies as well as transfers within the subject company may provide relevant information for estimating the current value.

Income Approach

The application of the income approach involves the determination of future economic income and the conversion of that income into value through the use of a risk-based discount or capitalization rate. Under the income approach, a series of economic income streams can be discounted or a single income stream can be capitalized to arrive at an indication of value. Therefore, the two basic methods under the income approach are the discounted future returns method, and the capitalized returns method. The use of the discounted returns method is preferred when current or historical earnings are not representative of future expectations. Both methods result in a present day value of a company's future income.

Asset-Based Approach

The asset-based approach focuses on the balance sheet of a business enterprise. Under the asset-based approach, the future benefits of ownership are realized through the hypothetical sale of a company's assets. An asset-based approach is generally used when the company's value depends on its tangible assets. An asset-based approach is appropriate for holding companies or for entities with no established earnings history, volatile earnings or a question as to whether it can continue as a going concern.

Capitalized Returns Method

Introduction

The capitalization returns method is developed using a single level of expected economic income which is converted to an indication of value by dividing it by a capitalization rate. The application of the method requires a determination of a level of normalized income and capitalization rate.

Capitalization Rate

The capitalization rate is used to convert a defined stream of income to an indication of value. The capitalization rate is derived from the discount rate, which represents the total expected rate of return that a buyer would demand on the purchase price of an ownership interest in the subject company given the level of risk inherent in that ownership interest. An underlying assumption in the capitalized returns method is that the economic income will have a constant average annual compounded rate of growth in perpetuity. Therefore,

the long-term growth rate is subtracted from the discount rate to arrive at the capitalization rate.

In determining the discount rate, I used the build-up method which is based on the principle that a company's discount rate (and related capitalization rate) is composed of a number of identifiable risk and return factors that, when combined, result in the total return that a prudent investor would demand from the purchase of the Company. Quantifying these risk factors is a two-step process. The first step is to determine a market rate of return, which can be obtained from published sources and consists of the following components:

1. Risk-free investment rate, based on the yield to maturity on long-term U.S. Treasury bonds as of the valuation date
2. An equity risk premium which represents the expected return that investors require by investing in the stock market over the return of the long-term U.S. Treasury bonds
3. An additional size premium for the extra risk associated with the small size of a potential acquisition candidate

The second step in developing the capitalization rate is to estimate the premium that a prospective investor would require to invest in a potential acquisition based on various risks unique to the potential target as of the valuation date.

Examples of assessment of risk could be based on variables such as:

1. The Company is not geographically diversified
2. The Company does not have a conventional bank credit facility
3. The Company has no management depth
4. The Company is smaller than many of its competitors

Normally capitalization rates are applied to "free cash flow" which is cash available to the shareholders after normal operating expenses, capital expenditures, and financing activities.

Transaction Method

Introduction

For the transaction method, a valuation multiple is applied to a specific financial measure to determine the operating value of a company. When determining the total value of equity, adjustments are often required to include the addition of current assets and subtraction of current or total liabilities.

Pricing multiples and the specific stream of economic returns can vary from industry to industry and are derived from direct analysis of market transactions. Multiples are influenced by a number of factors including the unique characteristics of the local economy, competition, business stability, acquisition opportunities, and other factors affecting the desirability of the business. Typically buyers are most interested in a business's most recent operating performance unless there is an explained anomaly or the historical performance indicates that the Company has reached a mature and stable stage of operation.

Examples of Market Transactions

- On April 30th, 1998 U.S. Pawn acquired Bobby's Pawnshop, Inc. for \$700,000
Value of the deal is 1.46 times inventories + Pawn loan receivables
- In September of 2003, Cash American International, Inc. acquired a five-store pawn lending chain for \$8.5 million. Value of the deal is 4.25x active loans
- On December 31, 2004 Cash America International, Inc. acquired Camco, Inc. d/b/a Superpwan for \$118.4 million. Value of the deal is 2.94 times loans receivable + inventory, 1.81 times annual revenue, and 19.45 times annual net income

In addition to specific market transaction information, Cash America International reported aggregate purchase information of 49 pawnshops, 153 cash advance locations, and 1 check cashing center acquired in 2003 and 2004. This information reflects the following valuation multiples:

- 2.55 times tangible assets
- 16.8 times annual net income

Valuation Multiples

Transaction multiples often include a premium for synergistic benefits when the acquirer is in the same industry as the target company. This is the situation for all the transactions discovered in most all transactions discovered in my research, and based off my past experiences in the M&A sector.

Valuation Discounts

Introduction

The next step in the valuation process is to determine whether any discounts should be applied to the indication of value based on other considerations. Typical discounts are for lack of control (minority interest discount) and lack of marketability.

Discount for Lack of Control

The owner of a controlling interest in a closely held business enjoys valuable rights that a minority interest owner does not. For example, a controlling owner can unilaterally direct the future course of the organization, acquire and dispose of assets, and determine management compensation to name a few.

Discount for Lack of Marketability

The concept of marketability deals with the liquidity of the interest of how quickly and certainly it can be converted to cash at the owner's discretion. In contrast to the liquidity of an investment in the stock market, closely held business interests are relatively illiquid. However, the owner of a 100% controlling interest has access and control of the Company's earnings and continues to benefit from these earnings during a pending sale. For a controlling interest, the discount for lack of marketability is normally based on the estimated costs of converting the business to a marketable investment. For this analysis, the additional risks related to reduce marketability are included in my discount rate.

A valuation using the transaction method under the market approach also results in a non-marketable value for the Company. Therefore, an additional discount for lack of marketability is not required.

As we can all see there could be a number of ways that I or any potential group could value your business.

I have a motto in my business, and it is “Always at your service”. Thank you for your attendance!

Respectfully – Jerry Whitehead -- Pawnshop Consulting Group

Statement of Qualifications

Jerry Whitehead - Consultant / Founder – Pawnshop Consulting Group

Leading Industry Consultant - Exit Strategies, Mergers/Acquisitions, Valuations, Forensic Auditing, Business and Financial Analysis, Business and Operational Consulting, Information Technology Systems Consulting, Capitalization and Financial Services, Human Resources Evaluator, Seminar Instruction and Key Note Speaking.

Over two decades of Business Management & Consulting with over 35 years in the industry as a second generation Pawnbroker.

Published Works

Author and Producer of the Seminar Series entitled “Exploring the Valuation Process of your Business for Possible Exit Strategies” Seminar Circuit 2006, Published in the National Pawnbrokers Association Magazine over 2006 – 2007 and Globalpawn Magazine 2006

Author and Producer of the Seminar Series – “What factors contribute and lead to a great Pawn Operation” Seminar Circuit 2006 – 2007, Published Globalpawn Magazine 2007

Author of a published series of articles titled “Training your Employees” as published in a series format from 2006 – 2007 in the National Pawnbrokers Association Magazine, Globalpawn Magazine 2006 and Today’s Pawnbroker 2007.

Author of a published series of articles titled “Progressive Training” as published in the National Pawnbrokers Magazine 2005 – 2006 and Globalpawn Magazine 2006.

Author of “Running A Great Operation” feature article as published in Today’s Pawnbroker 2007.

Contributor of many non-published articles and series pieces – National Pawnbrokers Association E-groups Members forum – 2002 – 2008, Compupawn Users Forum 2005 – 2008, Florida Pawnbrokers Association Members Forum 2002-2005.

Affiliations

1988 – 1991 Director – Texas Pawnbrokers Association

1990 – 2000 Advisory Board and Director – National Pawnbrokers Association

1998 – 2002 Director – Florida Pawnbrokers Association

1999 – 2001 President, - District 1 - Florida Pawnbrokers Association

2000 – 2008 Board of Trustees – National Pawnbrokers Association

National Pawnbrokers Association “Associate Vendor of the Year 2006”