AMERICAN BUSINESS APPRAISERS

Valuing U. S. Companies

Valuation of:

ABC Communications, Inc.

Date of Valuation: September 26, 20XX

Report Date: April 29, 20XX

Performed by:

Appraiser One, CBA, CMEA, ABAR, ASA
Certified Business Appraiser
Certified Machinery & Equipment Appraiser
Accredited Business Appraisal Review
Accredited Senior Appraiser

Independent Member of the

AMERICAN BUSINESS APPRAISERS

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AMERICAN BUSINESS APPRAISERS™

Certified Business Valuations and Machinery / Equipment Appraisals

It is the undersigned appraiser's independent unbiased professional opinion, using the valuation approaches and methods, which are subject to the assumptions and limiting conditions described in this appraisal report[1] dated April 29, 20XX, the fair market value of ONE equity voting share, in the 1,000 issued and outstanding shares of common stock, the only class of security issued, in this Arizona corporation known as ABC Communications, Inc., as of September 26, 20XX is best expressed as;

$1, 436.00
(One Thousand Four Hundred Thirty Six Dollars)

APPRAISER'S CERTIFICATION

- The statement of facts, opinions and conclusions expressed are correct to the best of the appraiser's knowledge and belief.
- The report analysis, opinions and conclusions are limited only by the reported assumptions and limiting conditions, and is this appraiser's personal, unbiased analysis, opinions and conclusions.
- The appraiser has no present or prospective interest in the property that is the Subject of this

The reader is reminded all useful information has been changed. This is a sample report to give you an idea of our final work product (report). The figures have been distorted, as well as other financial information contained this sample report.

valuation assignment.
- This appraisal has been prepared and this report has been prepared in conformity with Institute of Business Appraisers' *Business Appraisal Standards*, Uniform Standards of Professional Appraisal Practice (USPAP), and American Society of Appraisers' *Business Valuation Standards*.

As indicated above, our report and conclusions are attached hereto and must be attached to this transmittal letter as an integral part of it. Authorized reports will carry the appraiser's original signature in blue ink. Copies, which do not have the appraiser's signature in blue ink, are unauthorized and incomplete.

Appraiser One, CBA, CMEA, ABAR, ASA
Principal, American Business Appraisers

[1] As defined by The Appraisal Foundation USPAP 20XX-20XX Edition Standard Rule 10-2

Table of Contents

1 Introduction

1.1 Scope of the Assignment

Scope of work rule[2] states an appraiser must; (i) identify the problem to be solved; (ii) determine and perform the scope of work necessary to develop credible assignment results and (iii) disclose the scope of work in the report. This section of the valuation report discusses in detail the aforementioned.

1.2 Scope of Work Limitations

The scope of this appraisal assignment is limited to the development of a good-faith estimate or opinion of value based on the standard of value and assumptions set forth herein. The scope of this appraisal precludes forensic accounting, and is no more than a reasonable inquiry into the quality of management. This appraiser has relied on management's representations, without independent investigation or corroboration, and has no reason not to believe they fairly and accurately represent the financial status and activities of ABC Communications, Inc. (here after referred to as "the Subject"; "ABC Communications"; "ABC Communications" or "the Company").

Neither this engagement nor this report can be relied upon to disclose any misrepresentation, fraud, deviations from Generally Accepted Accounting Principles (GAAP), or other errors or irregularities. American Business Appraisers assumes no responsibility for legal or tax matters relative to its findings. The opinion of value is stated without reference to applicable legal or tax matters. ABC Communications, Inc. is considered in full compliance with all applicable local, state and federal laws, unless otherwise stated in this report.

1.3 Subject of the Appraisal

American Business Appraisers has been retained by ABC Communications, Inc. to provide an opinion on the fair market value of one-share of voting stock in ABC Communications, Inc., as of September 26, 20XX.

The purpose of the valuations is for estate planning purposes. Valuation is not an exact science, subject to a precise formula, but is based on relevant facts, elements of common sense, informed judgment and reasonableness. Therefore, this report and the values determined herein cannot be utilized or relied upon for any purpose other than that stated above.

1.4 Summary Description of Subject

ABC Communications carries a complete selection of quality wireless communication products including Microwave and Fiber Optic Systems by Alcatel and Harris, two-way radios by Motorola, ICOM, Kenwood, E.F. Johnson, and Harris, accessories, on-site paging, wireless internet access, and SCADA control systems. The Subject is an authorized Service Center for most brands of communication equipment and performs warranty repair service and complete system installations.

[2] Source: Uniform Standards of Professional Appraisal Practice (USPAP)

1.5 Restriction on Sale of Subject's Interest

There is no shareholders agreement. The Subject's shares are restricted only by operations of law, in that they are not registered securities.

1.6 Nature and Purpose (Use) of the Appraisal

The purpose of this appraisal is to estimate the fair market value as defined in Section 1.10. The appraisal will be used by the legal and financial representatives of ABC Communications, Inc. with regard to the settlement of the estate of Eric Bell.

1.7 Confidentiality and Privacy

This appraiser will maintain the conformity and privacy of ABC Communications' information obtained in the course of this valuation assignment in compliance with the Institute of Business Appraisers' *Business Appraisal Standards*, American Society of Appraisers' *Business Valuation Standards*, USPAP and Title V of Gramm, Leach, Bliley Financial Modernization Act.

Information about this client or their business model will not be sold to others. American Business Appraisers' objective is to protect the security and any confidential information about personal and business related activities. Information is shared outside American Business Appraisers only when necessary to administer products or services provided when we have permission, or when required or permitted by law or the courts.

1.8 Restricted Use of the Appraisal

The use and distribution of this appraisal report is restricted to: (i) the Shareholders of ABC Communications, Inc., (ii) and the legal and tax professionals advising with regard to the settlement of the estate of Eric Holder.

The use of this report and the information contained in it is restricted to the use set forth and if used for any other application is invalid.

1.9 Report Type

The valuation results are communicated in a summary limited format. This type of report format is commonly used when all parties are quite familiar with the operating conditions of the Company. A summary limited appraisal report is less detailed in nature than a comprehensive appraisal report. The appraiser's work file contains all the necessary information to produce a comprehensive appraisal report if requested to do so in the future.

1.10 Definition of the Standard of Value

The standard of value for this assignment is "fair market value"[3] and is defined as; the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's-

[3] Source: International Glossary of Business Valuation Terms

length in an open and unrestricted market, when neither is under any compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.

The fair market value standard includes the following assumptions:

- The equivalent of cash is being paid for the Subject's shares as of the valuation date.
- The interest being valued has been placed for sale on the open market for a reasonable amount of time for a sufficient number of potential buyers to be aware of its existence.
- The hypothetical buyer will not bring synergistic benefits to the seller's interest.
- The seller is not forced to sell (i.e., quick sale).
- The business will continue as a going concern and not be liquidated.
- The hypothetical buyer is assumed to provide financial and management skills significantly equivalent to those of the seller.

The buyer, under fair market value, is considered to be a financial buyer. This excludes a buyer who because of other business activities brings some value-added benefits to the Company, thus enhancing the Company, and the buyer's other similar business activities. This also excludes buyers who are already shareholders or relatives that might be willing to acquire the interest at an artificially greater or lower price due to considerations not typical of the arm's-length financial buyer.

The seller, in the fair market value appraisal process, is also hypothetical and is, therefore, prudent with knowledge of the relevant facts, *(i.e., the market influences on the value, risks specific to the business, specific factors that influence value and investment characteristics appropriate to ABC Communications, Inc.)*.

In the appraisal process, as it relates to the hypothetical status of the seller and buyer, the appraiser is a substitute for both parties and the independence of the appraiser is essential in determining the fair market value of the Company. The appraiser does not have a present or contemplated interest in the Company and has no personal bias with respect to the parties involved.

1.11 Effective Date of the Valuation (Appraisal Date)

The valuation date, the date of which the opinion of value applies, is September 26, 20XX. This is the date of death of Mr. Eric Holder. The opinion of value represented in this appraisal would likely change if the effective date was modified. The opinion of value is based on the premise that the Company will continue as a going concern and the business will remain an operating and ongoing enterprise.

The reader is informed the Company's financial data for 20XX is as of September 30, 20XX, four days after the valuation date. Management indicated no material change occurred during that short time period, so we accepted the September 30, 20XX data for use in this assignment.

1.12 Ownership and Control

As of the effective date of this appraisal the Subject has four shareholders in the common shares of stock, the only class stock issued and outstanding. The shareholders were represented to be as indicated in the following exhibit.

Exhibit 1-1

Common Shares Outstanding

Shareholder	*Shares*	*Percent*
Marsha Holder	390	39.0%
Eric Holder	290	29.0%
Edward Holder	160	16.0%
Patti Holder	160	16.0%
Total	1000	100.0%

1.13 Prior Ownership Transactions

Management states there have been no prior transactions in ABC Communications, Inc.

1.14 Principal Sources of Information

On December 16, 20XX this appraiser, visited the business and interviewed Patti Holder, Edward Holder, and Matt Davis of Davis, CPA's. The principal sources and documents used in the appraisal include the following:

- Federal tax returns for years ending December 31, 20XX thru December 20XX.
- Internal financial statements for the period January 1, 20XX thru September 30, 20XX.
- Information provided verbally by management of ABC Communications, Inc.
- The questionnaire completed by management.
- Industry information supplied by management.
- Research conducted with respect to the Subject's business and industry.
- Economic and industry studies, statistics and forecasts as mentioned in this report.
- Other sources which are footnoted throughout this report.

In all cases, this appraiser has relied upon the referenced information without independent verification. This report is, therefore, dependent upon the information provided. A material change in critical information relied upon in this report would be cause for a reassessment in order to determine the effect, if any, on this appraiser's conclusion of value.

1.15 Assumptions & Limiting Conditions

This appraisal is made subject to the following assumptions and limiting conditions:

1. The valuation process is not a finding of fact, but is a good faith finding of opinion. The opinion is supported by a reasonable amount of research and analysis, but is ultimately only the appraiser's personal, unbiased professional judgment.

2. This appraisal report is designed to provide an opinion of value. It is not an accounting report and should not be relied upon to disclose hidden assets or to verify financial reporting.

3. The valuation report is based upon facts and conditions existing as of the date of valuation. This appraiser has not considered subsequent events. Unless specifically requested by the client and agreed upon by me, I have no obligation to update this valuation report for such events and conditions.

4. The estimate of value included in this report assumes the existing business will maintain the character and integrity of the business through any sale, reorganization or reduction of any owner's/manager's participation in the existing activities of the business.

5. This valuation contemplates facts and conditions existing as of the Valuation Date. Events and conditions occurring after that date have not been considered in the related analysis unless such events were reasonably foreseeable as of the specific Valuation Date, and American Business Appraisers is not required to update our appraisal report for such events and conditions.

6. The ultimate price paid in any actual transaction is a function of negotiations between a specific buyer and seller, and those negotiations may be affected by individual interests not contemplated in our analysis. The timing of and conditions surrounding such a negotiation would differ from the effective date of our valuation. Therefore, we are not responsible for any buyer's or seller's ability or inability to consummate a transaction at the value developed herein.

7. This appraiser relied upon representations made by ABC Communications, Inc. regarding the background and history of the business. Management has acknowledged information provided was complete and accurate. However, this appraiser assumes no responsibility for the accuracy of the information provided to this appraiser by ABC Communications, Inc.'s representatives.

8. The various estimates of value presented in this report apply to this valuation only and may not be used out of the context presented. This valuation is valid only for the purpose specified.

9. The appraiser assumes no responsibility for the legal description or matters including legal or title considerations. Titles to Subject's assets, properties, or business interests are assumed to be good and marketable unless otherwise stated.

10. Subject's assets, properties, or business interests are appraised free and clear of any or all liens or encumbrances unless otherwise stated.

11. This report is based on financial information provided by management of ABC Communications, Inc. and other third parties. This appraiser has not audited the underlying financial data. Accordingly, this appraiser takes no responsibility for the underlying financial data presented in this report and users of this valuation report

should be aware that valuations may be based on future earnings potential that may or may not materialize. Therefore, the actual results achieved may vary from the information utilized in this valuation and the variations may be material.

12. American Business Appraisers accepted the financial statements of ABC Communications, Inc. without testing their accuracy. The financial statements consist of balance sheets and income statements. The accuracy of the financial statements is the sole responsibility of ABC Communications, Inc.'s management.

13. This appraiser is not aware of any information that was knowingly withheld. However, this appraiser makes no guarantee that ABC Communications, Inc. or others have disclosed all relevant information to this appraiser. The information furnished by others is believed to be reliable. However, American Business Appraisers issues no warranty or other form of assurance regarding its accuracy.

14. This appraiser assumes there are no hidden or unapparent conditions regarding the Subject's assets, properties, or business interests. The Subject is assumed to be in full compliance with all applicable federal, state, and local regulations and laws unless the lack of compliance is stated, defined, and considered in the appraisal report.

15. American Business Appraisers assumes that all required licenses, certificates of occupancy, consents, or legislative or administrative authority from any local, state, or national government, or private entity or organization have been or can be obtained or reviewed for any use on which the opinion contained in this report is based.

16. Unless otherwise stated in this report, this appraiser did not observe and has no knowledge of, the existence of hazardous materials with regard to the Subject's assets, properties, or business interests. However, this appraiser is not qualified to detect such substances and accepts no responsibility for such conditions or for any expertise required to discover them.

17. Neither this appraiser, nor American Business Appraisers, is a guarantor of value. Valuations of closely held companies are an imprecise science, with value being a question of fact and reasonable people can differ in their estimates of value. This appraiser, however, used conceptually sound and commonly accepted methods and procedures of valuation theory in determining the estimate of value included in this report.

18. Possession of this report, or a copy thereof, does not carry with it the right of publication of all or part of it, nor may it be used for any purpose without our previous written consent, and in any event only with proper authorization. Authorized copies of this report will be signed in blue ink by the appraiser of American Business Appraisers. Unsigned copies, or copies not signed in blue ink, should be considered to be incomplete.

19. The terms of this engagement do not require this appraiser to give testimony in court, be in attendance during any hearings or depositions, or appear at any Internal Revenue Service examination, with reference to the Company being valued, unless previous arrangements have been made.

20. Neither all nor any part of the contents of this report shall be disseminated to the public through advertising, public relations, news, sales, or other media without our prior written consent and approval.

21. American Business Appraisers are not licensed attorneys. Any comments, discussions, or analyses of Company documents or any other federal or state law, provision, or regulation are not to be considered legal opinions. The appraiser's focus is to consider all relevant factors that might impact value and estimate the extent of the impact of such factors.

22. The analyses, opinions, and conclusions presented in this report apply to this engagement only and may not be used out of the context presented herein. This report is valid for the effective date specified herein and only for the purpose specified herein.

23. The analyses, conclusions and opinions are based on information and data provided as of the date of valuation and could change, based on obtaining additional information and having additional time to analyze such additional data. This appraiser, therefore, reserves the right to amend this report based on additional analysis and data. Further, in the case of testimony, this appraiser reserves the right to offer rebuttal testimony.

24. To ensure compliance with requirements imposed by the IRS, this appraiser informs you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of; (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

2 Analysis of the Organization

2.1 History

ABC Communications, Inc. was founded in 1944 as ABC Carrier, and later purchased by the Holder Family. From the basic two-way radio of the 1950's the Company now offers complex microprocessor based systems. The Company was incorporated in the state of Arizona in 20XX, and operates under the name ABC Communications. Eric Holder passed away on September 26, 20XX, prompting his son Edward to run the day-to-day operations.

2.2 Form of the Organization

The Subject has elected to be taxed as an "S" Corporation under the Internal Revenue Code and comparable Arizona tax law. As an "S" Corporation, all taxable income of the Company flows through and is taxable to the stockholders of the Company.

2.3 Location

ABC Communications' headquarters are located at 29902 N. East St., Mesa, AZ. The specific location is not critical to operations and a change of location would appear to have no impact other than the associated moving costs and inconveniences.

2.4 Operations

ABC Communications, Inc. is a wireless communications company. The Company carries a complete selection of quality wireless communication products including Microwave and Fiber Optic Systems by Alcatel and Harris, two-way radios by Motorola, ICOM, Kenwood, E.F. Johnson, and Harris, accessories, on-site paging, wireless internet access, and SCADA control systems. The Subject is an authorized Service Center for most brands of communication equipment and performs warranty repair service and complete system installations.

2.5 Management and Employees

As of the valuation date, ABC Communications employed approximately 21 employees. Substantially all of the employees are employed full-time, and there are no collective bargaining agreements covering any of the employees. Management considers its relations with their employees to be satisfactory, and no labor disputes are anticipated, nor have any affected operations negatively. Wage rates vary by position. Key management of ABC Communications includes the Holder family members.

With the passing away of Eric Holder, Edward Holder (age 57), who was the Vice-President, is now the President. Mr. Holder works approximately 80 hours per week for an annual salary of $96,000 plus the benefits provided to all eligible employees. Mr. Holder has a BS Engineering degree and an AZ contractor's license. As president his duties include overseeing the day-to-day operations of the entire business.

Patti Holder (age 46), Secretary, works approximately 40 hours a week at a weekly salary of $720 plus benefits. She delegates 90% of her time to office duties and 10% towards sales.

Marsha Holder (age 70), Treasurer, works approximately 40 hours per week for a weekly salary of $400 plus benefits. Mrs. Holder delegates 100% of her time to office and accounting duties.

2.6 Product and Service Lines

The Company's primary products/services are: SCADA/Microwave (34%), two-way radio sales (25%), cellular (18%), mountain-top rental (13%), service (9%), and paging (1%).

2.7 Customer Base

The Company's primary customers are:

- Customer One
- Customer Two
- Customer Three
- Customer Four

Three customers account for approximately 35% of the Company's revenue - the U.S. Air force (25%), County Roads (5%), and Sheriff (5%).

2.8 Competition

Management indicated that the Company's primary competitors are XYZ Radio located in Mesa and XYZ Communications located in Phoenix. Management believes XYZ Radio is significantly smaller than the Subject, while XYZ Communications is 50 percent larger.

The basic products offered are very similar; however, the Company does have an exclusive agreement with Bell to sell multi band radios to local governmental units. In addition, the Company is the sole source for ABCD Interface sales to the U.S. Army. Competition is, in general, aggressive; however, the Company has a good reputation for service, price, and mountain top sites.

2.9 Environmental, Regulatory and Other Conflicts

Management did not identify environmental nor regulatory issues of serious consequence.

2.10 Sales and Marketing

Approximately 50% of the Company's sales are generated from repeat customers, with the balance from referrals and advertising. The Company uses several methods of advertising; radio (70%), television (25%), and the yellow pages (5%). In addition, the Company has a website: www.abcomm.com.

Marketing for the Company is minimal as indicated by the advertising expense on ABC Communications' financial statements. The Company has been in existence in the same location for 66 years and is well known to the customers it serves.

The Company's normal operating hours are 8:00 a.m. to 5:00 p.m. Monday through Friday and 10:00 a.m. to 2:00 p.m. on Saturday. The Company also offers emergency on-call 24 hours, 7 days a week, if needed.

2.11 Suppliers and Vendors

ABC Communications Inc. has favorable relations with all its vendors, and has traded with many of them for some period of time. The Company has 50 plus suppliers; key suppliers are ABC (P25 high-end digital radios), DEFl (high-end microwave radios), GHI (commercial grade radios and PTP systems), and MNO (ancillary items). On the cellular side of the business, Verizon is a key supplier.

2.12 Barriers to Entry

The industry has moderate barriers to entry. The primary requirements are establishing relationships with manufacturers and industry experience.

2.13 Future Prospects for the Subject

Technology is moving from analog to narrow band and digital. All wide band analog two-way radios systems (25 KHz) are required to move to narrowband (12.5 KHz) by January 1, 20XX. This transition should have a positive impact on revenues. Overall, the business should experience slightly faster growth in sales in 20XX, 20XX and 20XX and then return to historical growth rates.

2.14 Implications for the Subject

Based on this analysis, we believe the Subject is competitive in terms of breath of market served and the availability of products and services. Therefore, we believe ABC Communications has the potential, from an operations standpoint, for continued growth. However, the Subject lacks management depth and has a limited sales and marketing program. These factors increase the Subject's risk and will be considered in our forecasted income statements and our choice of a specific-company risk premium.

3 Economic Conditions

As with any business operating as a going concern, the status of the economy and the particular industry will certainly impact revenues, operations and profitability. This section is used to inform the reader of the economic and industry factors considered relevant and material to the appraisal process and opinion of value conclusion.

In any business valuation, the general economic outlook as of the appraisal date should be considered, since the national economic outlook is often the basis of how investors perceive alternative investment opportunities at any given time. In this analysis, the appraiser has examined the general economic climate that existed at the end of September 20XX.

3.1 General National Economic Conditions[4]

As the U.S. economy continues to climb out of the deepest recession since World War II, the growth remains remarkably slow, suggesting that the emergence from recession will continue to be a long and difficult struggle.

The gross domestic product (GDP), the broadest measure of the U.S. economy, grew at an annual rate of 2.0% in the third quarter of 20XX. This came after a downwardly revised rate of 1.7% in the second quarter and 3.7% in the first quarter of 20XX. According to the initial report, growth in the third quarter stemmed primarily from consumer spending and business inventory buildup.

Exports continued to rise faster than imports, resulting in the trade deficit subtracting two percentage points from the third quarter's GDP. Josh Bivens, an economist at the Economic Policy Institute, expects this to be a problem going forward. "While trade flows were less of a drag on growth compared to the previous quarter, it seems clear that the trade deficit is poised to quickly regain its pre-recession level unless policy changes are made to allow the U.S. dollar to gain competitiveness against major trading partners," said Bivens.

[4] *Source: "Part of the contents of the economic section of this valuation report is quoted from the Economic Outlook Update™ 3Q 20XX published by Business Valuation Resources, LLC, © 20XX, reprinted with permission. The editors and Business Valuation Resources, LLC, while considering the contents to be accurate as of the date of publication of the Update, take no responsibility for the information contained therein. Relation of this information to this valuation engagement is the sole responsibility of the author of this valuation report."*

"Given that a rising trade deficit will slow economic growth and job-growth over the next couple of years and is undesirable over the longer-run as well, this is a very troubling sign in the current recovery," continued Bivens.

The Council of Economic Advisers, an agency within the Executive Office of the President, acknowledged that "faster growth is needed to bring down the unemployment rate more quickly." The Council went on to state, "Given the depth and severity of the recession, considerable work remains before our economy is fully recovered."

Bivens noted that, at the end of the third quarter of 20XX, the "GDP remains 0.8% lower than it was in the fourth quarter of 20XX, the pre-recession peak. On average, the economy is 8.6% larger 11 quarters after a recession begins. While this historically low GDP recovery is largely a function of the severity of the recession, the GDP is now five quarters into recovery, and these five quarters have seen exceptionally slow growth—beating only the performance following the trough of the 20XX recession (among recoveries that lasted five quarters or more)."

3.1.1 Gross Domestic Product

The U.S. Department of Commerce reported that the nation's economy—as indicated by the GDP—increased at an annual rate of 2.0% in the third quarter. This was the fifth straight quarter of economic growth. The economy grew at a (revised) 1.7% annualized rate last quarter and 3.7% in the first quarter of 20XX. The GDP is the total market value of goods and services produced in the U.S. economy. The GDP and is generally considered the most comprehensive measure of economic growth.

Economists had expected a slightly stronger growth rate of 2.1%. The government sector added to growth this quarter, but the housing market was a renewed drag on U.S. economic activity as the stimulus boost from the homebuyer tax credit ended in April.

The increase in third quarter real GDP primarily reflected positive contributions from:

- personal consumption expenditures;
- change in private inventories;
- household consumption expenditures for services;
- business expenditures on equipment and software;
- nonresidential investment;
- and government consumption expenditures and gross investment.

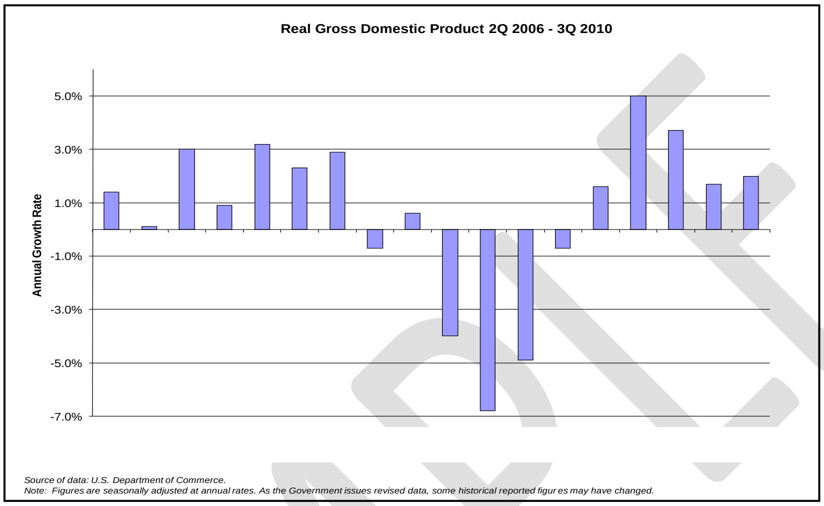
The deceleration in third quarter real GDP primarily reflected:

- an acceleration in imports;
- a deceleration in residential fixed investment.

Economists think that some of the inventory buildup was unintentional as goods stayed sitting longer on shelves. This suggests weaker growth in coming months.

Although both imports and exports grew in the third-quarter, imports grew faster, resulting in a negative 2.01 percentage point contribution to the real GDP. Motor vehicle output added 0.42

percentage points to the third-quarter change in real GDP after subtracting 0.06 percentage points from the second-quarter change. Final sales of computers added 0.25 percentage points to the third-quarter change in real GDP after adding 0.03 percentage points to the second-quarter change. Despite the third-quarter's growth, the economy contracted by 2.6% in 20XX. The economy grew by 0.0% and 1.9% in 20XX and 20XX, respectively. The following graph shows the U.S. real gross domestic product from the second-quarter 20XX through the third-quarter 20XX.



3.1.2 Consumer Spending

Consumer spending grew at a rate of 2.6% during the third quarter of 20XX. This is up from a rate of 2.2% in the prior quarter. Consumer spending has now grown for four consecutive quarters. Consumer spending—also referred to as personal consumption—accounts for approximately 70% of the U.S. GDP. The third-quarter's growth in consumer spending contributed 1.79 percentage points to the third-quarter GDP. This compares with a contribution of 1.54 percentage points to the GDP in the previous quarter, and 1.33 percentage points to the GDP in the first quarter of 20XX.

Overall consumer spending declined by 1.2% in 20XX and 0.3% in 20XX, but grew by 2.4% in 20XX. Consumer spending on durable goods—items meant to last three or more years—increased at a rate of 6.1% this quarter, compared with a rate of 6.8% in the previous quarter. Consumer spending on durable goods declined 3.7% in 20XX, after decreasing 5.2% in 20XX and increasing 4.2% in 20XX. Consumer spending on nondurable goods—items such as food and gasoline—increased 1.3% this quarter, compared with an increase of 1.9% last quarter. Consumer spending on nondurable goods decreased by 1.2% in 20XX, after decreasing 1.1% in 20XX and increasing 2.0% in 20XX.

3.1.3 Government Spending

Total government spending increased at a rate of 3.4% in the third quarter of 20XX. Government spending grew at a rate of 3.9% in the second quarter but declined 1.6% in the first quarter. The third quarter's growth in government spending made a 0.68 percentage point contribution to the third quarter GDP. The previous quarter's growth in government spending had a positive 0.80 percentage point effect on the second quarter GDP. Total government spending grew by 1.6% in 20XX, 2.8% in 20XX, and 1.3% in 20XX. Federal government spending increased at a rate of 8.8% in the third quarter, after increasing 9.1% in the previous quarter. Federal government spending grew by 5.7% in 20XX, after growing 7.3% in 20XX and 1.2% in 20XX. National defense spending increased at a rate of 8.5% in the third quarter, after increasing 7.4% in the previous quarter. National defense spending grew by 5.4% in 20XX, following growth of 7.5% in 20XX and 2.2% in 20XX.

State and local government spending declined by 0.2% in the third quarter. State and local government spending increased 0.6% in the previous quarter. State and local government spending declined 0.9% in 20XX, after growing 0.3% in 20XX and 1.4% in 20XX.

3.1.4 Consumer Prices and Inflation Rates

According to the U.S. Department of Commerce, the price index for gross domestic purchases, which measures prices paid by U.S. residents, increased 0.8% in the third quarter. This compares with a 0.1% increase in the second quarter. Excluding food and energy prices, the price index for gross domestic purchases increased 0.6% in the third quarter, compared with an increase of 0.8% in the second. The U.S. Department of Labor reported that the Producer Price Index for Finished Goods increased 0.4% (seasonally adjusted) in September, following increases of 0.4% in August and 0.2% in July. The Producer Price Index for Finished Goods measures inflationary pressures before they reach consumers. On an unadjusted basis, prices for finished goods have risen 4.0% over the last 12 months.

The costs of intermediate goods increased 0.5% in September after increasing 0.3% in August. The September rise for the intermediate goods index was broad-based, with prices for foods and feeds climbing 2.1%. The index for intermediate goods less foods and energy moved up 0.2% and prices for energy goods advanced 0.7%. On a 12-month basis, the intermediate goods index increased 5.6% for September, its tenth consecutive year-over-year rise.

The U.S. Department of Labor reported that the Consumer Price Index for All Urban Consumers increased 0.1% (seasonally adjusted) in September. The index increased 0.3% in both August and July. The Consumer Price Index is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Over the last 12 months, the index increased 1.1% before seasonal adjustment. The index decreased 0.4% in 20XX after increasing 3.8% in 20XX and 2.8% in 20XX. Exhibit 3-1 illustrates historical and Consensus Forecasts for several economic factors.

Exhibit 3-1

Historical Economic Data and Forecasts 2005-2019

	Historical Data						Consensus Forecasts					
	20XX	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**	**XX'-XX'**
Gross Domestic Product (GDP)	3.1	2.7	1.9	0.0	-2.6	2.7	2.4	3.3	3.4	3.1	2.9	2.6
Industrial Production	3.3	2.2	2.7	-3.3	-9.3	5.5	4.1	4.1	3.6	3.4	3.1	2.8
Personal Consumption	3.4	2.9	2.4	-0.3	-1.2	1.6	2.1	2.7	2.7	2.8	2.7	2.5
Government Spending	0.3	1.4	1.3	2.8	1.6	0.8	0.6	n/a	n/a	n/a	n/a	n/a
Consumer Price Index (CPI)	3.4	3.2	2.8	3.8	-0.4	1.6	1.5	2.0	2.1	2.1	2.1	2.3
Unemployment Rate	5.1	4.6	4.6	5.8	9.3	9.7	9.4	n/a	n/a	n/a	n/a	n/a
Housing Starts (millions)	2.068	1.801	1.355	0.906	0.554	0.600	0.760	n/a	n/a	n/a	n/a	n/a

3.1.5 Interest Rates

The Federal Open Market Committee (FOMC or the "Committee") met twice during the third quarter of 20XX, issuing two statements on their target for the federal funds rate. The federal funds rate is the interest rate at which a commercial bank lends immediately available funds in balances at the Federal Reserve to another commercial bank. At their first meeting this quarter (August 10), the FOMC decided to keep the target for the federal funds rate unchanged at a range of 0% to 0.25%. The press release stated that the pace of recovery in output and employment has slowed in recent months. Although household spending increased, the FOMC found that it is still constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Although business spending on equipment and software had risen significantly, investment in nonresidential structures continues to be weak and employers remain reluctant to add to payrolls. The FOMC also noted that housing starts remain at depressed levels and bank lending has continued to contract. The Committee also expected inflation to remain subdued for some time.

At their last scheduled meeting during the third quarter (September 21), the FOMC again left the target for the federal funds rate unchanged at 0% to 0.25%. The Committee reiterated everything they had said at their August meeting. They again noted that bank lending continued to contract, but at a reduced rate in recent months.

During the third quarter of 20XX, the Board of Governors of the Federal Reserve left the discount rate unchanged at 0.75%. The discount rate is the interest rate a commercial bank is charged to borrow funds, typically for a short period, directly from a Federal Reserve Bank. The board of directors of each Reserve Bank establishes the discount rate every 14 days, subject to the approval of the Board of Governors.

3.1.6 National Economic Outlook

The economy has grown for five consecutive quarters, but most economists are now pointing pessimistically at the inadequate rate of GDP growth. The GDP remains below its pre-recession peak. The Institute for Supply Management's Manufacturing Index (PMI) fell at the end of the third quarter, as did The Conference Board's Consumer Confidence Index. The Mortgage Bankers Association® revised their previous forecasts downwards for housing starts, building permits, and home prices. Unemployment remains nearly unchanged from the second quarter, and will likely remain unchanged until economic growth quickens its pace.

Lynn Franco, Director of The Conference Board Consumer Research Center, believes "Overall, consumers' confidence in the state of the economy remains quite grim. And, with so few expecting conditions to improve in the near term, the pace of economic growth is not likely to pick up in the coming months."

According to Consensus Economics, Inc., publisher of *Consensus Forecasts - USA*, real GDP is forecasted to increase at a seasonally adjusted annual rate of 2.2% in the fourth quarter of 20XX, then at a rate of 2.3% in the first quarter of 20XX. They reported that GDP is forecasted to grow 2.7% in 20XX, 2.4% in 20XX, and 3.3% in 20XX. In the long term, they report that the consensus is that real GDP will grow by an average annual rate of 2.6% between 20XX and 20XX. Every month, Consensus Economics surveys a panel of 28 prominent U.S. economic and financial forecasters for their predictions on a range of variables including future growth, inflation, current account and budget balances, and interest rates. The survey reports that unemployment is forecasted to average 9.7% in 20XX, before averaging 9.4% in 20XX.

According to the survey, consumer prices will increase 1.6% in 20XX, 1.5% in 20XX, and 2.0% in 20XX. In the long term, the survey finds that consumer prices are forecasted to grow at an average annual rate of 2.3% between 20XX and 20XX. In addition, producer prices are forecasted to increase 3.9% in 20XX and 1.2% in 20XX. Real disposable personal income is expected to grow 1.3% in 20XX and 1.8% in 20XX.

Interest rates on three-month Treasury bills and 10-year Treasury bonds are expected to rise over the next year. According to the survey, the three-month Treasury bill rate will rise to 0.2% by the end of January 20XX, and then to 0.4% by the end of October 20XX. The yield on the 10-year Treasury bond will rise to 2.7% by the end of January 20XX, and then to 3.5% by the end of October 20XX.

The 40 participants in *The Livingston Survey* released their newest predictions in June. The forecasters, who are surveyed by the Federal Reserve Bank of Philadelphia twice a year, project real GDP to grow at an annual rate of 3.3% between 2Q 20XX and 4Q 20XX (this is up from their previous estimate of 3.0%). They then expect GDP to increase at an annual rate of 3.0% between 4Q 20XX and 2Q 20XX. They believe GDP will grow 2.8% annually over the next 10 years.

The survey also noted that forecasts for the unemployment rate have been revised downward for 20XX, though unemployment is still expected to remain above 9% into the middle of 20XX. The forecasters expect the unemployment rate will decrease to 9.5% by December 20XX, down from their previous estimate of 9.9%. They expect unemployment to drop to 9.1% by June 20XX.

The forecasters in *The Livingston Survey* have lowered their predictions for consumer price (CPI) inflation. They expect CPI inflation to average 1.8% in 20XX, down from the previous estimate of 2.2%. They predict CPI inflation will be 1.7% in 20XX. Inflation (as measured by the consumer price index) is predicted to average 2.3% over the next 10 years, slightly lower than the forecast of 2.4% estimated in the prior *Survey*. The *Survey* expects that producer price (PPI) inflation will average 4.1% in 20XX—up from the previous estimate of 2.4%—before averaging 2.4% in 20XX.

3.1.7 Main Street

A variety of statistics are available which, when examined together, provide a gauge of the health of main street business in the U.S. First, non-farm proprietor's income grew a seasonally adjusted annual rate of 3.5 percent in the third quarter. This sector outperformed the economy generally as overall personal income grew by 2.1 percent for the period.[5] Next, the cost of funds to main street businesses remained relatively low. For example, the commercial bank prime loan rate was 3.39 percent in August 20XX, virtually unchanged since December 20XX. The

Main Street Source: Written by Dr. Jeff Collins specifically for American Business Appraisers.
[5]U.S. Department of Commerce, Bureau of Economic Analysis, *Personal Income and Outlays, September 20XX,* Released November 1, 20XX.

average interest rate for small loans (less than $100,000) was 4.54 percent according to an August 20XX survey of all commercial banks.[6]

In addition, bankruptcy data indicated business bankruptcies decreased 3.4 percent from second quarter 20XX to third quarter 20XX, the most recent data available.[7] Small business loan demand was up slightly from first to second quarter but remained weak.[8]

3.2 Overview of the Regional Economy

The outlook for the local economy is important since a portion of the cost of doing business is influenced by local economic conditions. Therefore, we considered the economic outlook for the state of Arizona as of September 20XX.

The Subject is located in Mesa, which is in central Arizona. The city's population is approximately 60,000. The population of the Metropolitan Statistical Area is approximately 127,000.

According to the U.S. Department of Commerce, Arizona's per-capita personal income rose 3.1 percent in 20XX, a rate of growth much lower than the national average of 6.6 percent. Arizona has a per-capita income of $32,935. The nation's per-capita income, in 20XX, was $39,138.

Arizona's unemployment rate was 9.7 percent in September 20XX, unchanged from August. Meas' unemployment rate is approximately 7.6 percent, which is lower than the state average.

The median income for a household in Mesa is approximately $37,100 (compared to approximately $48,000 for the state of Arizona). Approximately 90 percent of Meas' population has a high school degree or higher and 39 percent has a bachelor's degree or higher.

The major economic concerns facing the state and Mesa include housing, credit markets, and energy prices. According to the University of Arizona the overall outlook for the Arizona economy is for a modest improvement in 20XX. "Population and employment will both grow at less than 2% annual rates. Personal income will eke out a very modest sub-four percent gain. Replacement buying will lift retail sales but consumers will continue to exercise their newly found emphasis on thrift. The following year, 20XX will see the pace quicken but it will be 20XX before employment growth tops 100,000 and population growth approaches 170,000, levels that were common during the late 1990s."[9]

3.3 Implication to our Subject

The local and regional economy appears to be poised for at least a mild improvement. Inflation is expected to moderate although there is ongoing risk due in part to high energy and commodity prices. These indications are all unfavorable for the Subject. These factors will be considered in our choice of the Subject's sales forecast. This appraiser's summary risk analysis of the national, state and local economy implies the following:

- Growth in Revenues should very likely continue at a moderate pace for the near term future.

[6] Federal Reserve Statistical Release, *Survey of Terms of Business Lending*, released October 6, 20XX.
[7] U.S. Courts, Retrieved from: http://www.uscourts.gov/bnkrpctystats/statistics.htm.
[8] U.S. Small Business Administration, Office of Advocacy: Quarterly Indicators, Second Quarter 20XX.
[9] Source: http://azeconomy.eller.arizona.edu/AZE10q4/recovery_soft.asp

- Profit Margins (i.e., operating) may continue to increase at a moderate level.
- Borrowing Costs (i.e., interest rates) likely to remain relatively low for the interim period.
- Business Risk (i.e., volatility of economy) improving but at a moderate rate.
- Financial Risk (i.e., likelihood of bankruptcy) is low.

4 Overview of the Industry

Unfortunately, not every business fits neatly within the Standard Industrial Classification code (SIC) or the new North American Industrial Classification System (NAICS). This appraiser has determined after researching both classification code categories the Subject reasonably fits into NAICS 51721, Wireless Telecommunication Carriers (except satellite). Establishments primarily engaged in the telecommunications industry include:

- NAICS 517211 Paging: This industry comprises establishments primarily engaged in operating paging networks. The establishments of this industry may also supply and maintain equipment used to receive signals.

- NAICS 517212 Cellular and Other Wireless Telecommunications: This industry is primarily engaged in operating cellular telecommunications and other wireless telecommunications networks (except paging).

4.1 Industry Overview[10]

The US wireless telecommunications services industry includes 3,000 companies with combined annual revenue of about $190 billion. Major companies include four national wireless carriers: AT&T, Verizon, Sprint Nextel, and T-Mobile USA (an indirect subsidiary of Deutsche Telekom). The industry is highly concentrated: the 50 largest companies generate more than 90 percent of industry revenue.

4.1.1 Competitive Landscape

Demand for wireless services is driven by consumer income and innovative service offerings. The profitability of individual companies depends on marketing and customer service. Large companies have advantages in marketing and in delivering a comprehensive array of services nationally. Small companies can compete effectively by delivering economically attractive service packages tailored to niche groups regionally. The industry is capital-intensive: average annual revenue per employee is more than $900,000.

4.1.2 Products, Operations & Technology

Major services provided include voice telephony (ordinary cell phone service); messaging (voice, text, image, and video); Internet access; music and video distribution; and ringtone distribution. While voice telephony traditionally has dominated wireless network traffic, data is expected to surpass it.

[10] Source: First Research "Telecommunications Services" December 6, 20XX

Cellular communication networks consist of a series of low power base transceiver stations (BTS) interconnected through a regional base controller (BCS) to a mobile switching center (MSC). The BTS, or cellular tower, consists of a set of antennae mounted on a tall structure or tower with a large two-way radio. The BTS communicates with mobile phones and devices in its geographical area, or cell. The BSC, which controls communications with up to several hundred cellular towers in a geographic area, allocates radio channels to individual mobile phones and controls handovers from one cellular tower to another. The mobile switching center connects calls between network users and is also connected to the wired phone system, the public switched telephone network (PSN).

4.1.3 Sales & Marketing

About 90 percent of wireless services sales are directly to end-users; the remainder are to resellers. With about 90 percent of the population subscribing to cell phone services, the market of new subscribers is diminishing rapidly. Companies make heavy use of TV and print advertising, and sell through their own stores or through counters in chains like Best Buy, Wal-Mart, and Radio Shack

To sustain revenue growth, cellular operators try to attract subscribers from other operators, identify underserved niches in the population, or increase the average revenue per subscriber. Customer churn, in which subscribers switch carriers, drop wireless service, or have service deactivated for failure to pay, averages around 1.5 percent of subscribers per month.
The Internet is an increasingly important venue for sales of services and accessories. Large providers use their own websites as well as third-party retail sites to sell such ancillary products as wireless handsets. Web sales are often supported by online or phone-based assistants who handle purchase and technical support issues.

Average revenue per user (ARPU), a key industry metric, is about $50 per month, and has declined slightly with the addition of family plans and the growth of prepaid accounts. Increasing ARPU depends on offering new fee-based services such as text messaging. Many users upgrade from basic voice to services like Internet access, music and video on-demand, and GPS.

4.1.4 Finance & Regulation

Wireless communications is a capital-intensive business. Upfront capital investment is required to acquire spectrum, build out the network, open and staff business and sales offices, and advertise. Since the network must be in full operation, at least regionally, before subscribers can be signed, acquiring the substantial capital required is a major barrier to entry. Once in operation, the cost of serving additional customers is fairly low, so companies launch expensive sales and marketing campaigns to add large numbers of customers as quickly as possible.

Mergers and acquisitions (M&A) have been a major factor in the industry. Most M&A are intended to consolidate operations or fill in areas in the national network. Regulatory changes that encourage competition have also spurred M&As.

The FCC is responsible for allocating the electromagnetic spectrum in the US and overseeing the activities of licensed telecommunication companies. Company operations are generally defined in terms of a cellular market area (CMA), one of the 366 metropolitan statistical areas, or one of the 574 metropolitan statistical areas (less than 50,000 population) in the US. The FCC uses auctions to allocate licenses in each market. To maintain competitive balance, credits are given to small businesses for some of the frequencies. The FCC also reserves certain frequencies for public service and military use. The FCC also evaluates operations to assure that licensees meet legal requirements and operate "in the public interest." If licensees don't use allocated spectrum within a fixed period (usually 10 years), the FCC can repossess the frequency and re-auction it. Auction winners may swap or sell their frequencies to others.

4.2 Business Challenges

Dependence on Consumer Income - Demand for high-end services, such as video distribution and interactive GPS mapping programs, depends on growth in US personal income. These high-end services are key to profitability for many wireless operators. As personal income stagnates or declines, consumers tend to forgo high-end services and revert to basic voice and text message services.

Market Saturation - With about 90 percent of the US population already subscribing to wireless services, companies must attract subscribers from other carriers to sustain revenue growth. Competition for subscribers is intense, as nearly all US consumers have at least four wireless carriers to choose from. Companies invest heavily in advertising and promotions to convince consumers to switch to their service and to counter competitive attacks on their own customer base.

4.3 Trends & Opportunities

Stagnant Average Revenue Per User - Average revenue per user (ARPU) has hovered around $50 per month for several years. While subscribers are gradually adding services, new users are often lower-use individuals (family members, low-income individuals, pay-as-you-go users). Data services - including text messaging, Internet access, and email - have boosted ARPU for many companies in recent years, although many also struggle with declining voice service ARPU.

Productivity Growth - Subscriber growth has far outpaced employment growth in the wireless telecom industry, thanks to productivity gains. While there was 160 percent more wireless subscribers in 20XX than in 20XX, industry employment grew only 5 percent during the same period. The average number of subscribers per employee rose almost 150 percent between 20XX and 20XX, driven by increased automation and outsourcing, according to The Wireless Association (CTIA).

Cell Phone as Primary Phone - Wireless replacement of landline phones has grown significantly in recent years. Wireless-only households in the US nearly tripled between 20XX and 20XX to 25 percent. The percentage of cell phone dependent households is expected to continue to grow in the coming years, particularly as young adults establish their own households.

4.4 Industry Forecast

The output of US paging, cellular, and wireless telecommunications is forecast to increase at an annual compounded rate of 11 percent between 20XX and 20XX.

4.5 Implication to our Subject

ABC Communications has established itself as a niche provider of wireless communication products. The overall industry is growing faster than the general economy. New government regulations for narrow band frequency use will favorably impact revenues over the next two or three years.
This appraiser's summary risk analysis of the industry conditions and outlook implies the following:

- Growth in sales should likely increase in 20XX and 20XX and return to historic levels thereafter.
- Profit Margins (i.e., operating) continue at moderate levels.
- Borrowing Costs (i.e., interest rates) rate should remain low for the next five years.
- Business Risk (i.e., competition) increasing market presents, but at a moderate pace.
- Financial Risk (i.e., likelihood of bankruptcy) extremely low.

5 Financial Analysis of the Subject

5.1 Historical Financial Statements

Detailed income statements and balance sheets were relied upon for this appraisal, and are summarized in this section of the report. The actual financial statements and tax returns provided to us are contained in the appraiser's work papers. ABC Communications provided internally prepared un-audited financial statements for fiscal years ending December 31, 20XX thru September 30, 20XX.

Generally the analysis of ABC Communications' financial statements (income statement and balance sheet), are performed in order to assist in measuring trends, and identifying assets and liabilities of ABC Communications.

The balance sheet is a statement of the status of the business as of a specific date. The income statement is a statement of financial activities of the business over a period of time. These statements together, along with information regarding the industry's performance are tools of analysis used in this section of the report.

5.1.1 Balance Sheet Analysis

The Balance Sheet indicates the financial status of a business as of a certain date. Year-end balance sheets for years' 20XX thru 20XX and September 30, 20XX were used to compile this information. Exhibit 5-1 presents Unadjusted Balance Sheet analysis.

Reviewing data in Exhibit 5-1 is complex in an absolute number format. By converting absolute numbers into terms of a percentage, the data becomes more meaningful and easier to analyze. This conversion is called "common-sizing" and allows year-to-year comparison between total assets against various line items.

Exhibit 5-1

Historical Internal Analysis of Balance Sheet

	Balance Sheet				*Common-size as a % of Total Assets*			
	20XX	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**
Months of Operations in Year	*12*	*12*	*12*	*9*	*12*	*12*	*12*	*9*
Assets								
Cash	647,438	518,945	808,197	586,392	56.1	29.6	54.5	48.1
Receivables	218,942	802,152	433,989	297,039	19.0	45.7	29.3	24.3
Inventory	16,235	16,235	16,235	56,515	1.4	0.9	1.1	4.6
Other	26,734	209,238	88,061	40,664	2.3	11.9	5.9	3.3
Total Current Assets	909,349	1,546,570	1,346,482	980,610	78.8	88.2	90.8	80.4
Total FF&E Assets	790,821	818,101	924,188	973,731	68.5	46.7	62.3	79.8
Total Accum Depreciation	(624,083)	(666,687)	(788,053)	(807,071)	(54.1)	(38.0)	(53.2)	(66.1)
Net FF&E Assets	166,738	151,414	136,135	166,660	14.5	8.6	9.2	13.7
Intangible Assets (net)	-	-	-	-	-	-	-	-
Other	77,612	55,449	-	72,940	6.7	3.2	-	6.0
Total Assets	1,153,699	1,753,433	1,482,617	1,220,210	100.0	100.0	100.0	100.0
Liabilities & Equity								
Short Term Debt	-	-	-	-	-	-	-	-
Payables	57,176	154,405	135,514	297,115	5.0	8.8	9.1	24.3
Other	600,760	874,632	304,586	195,005	52.1	49.9	20.5	16.0
Total Current Liabilities	657,936	1,029,037	440,100	492,120	57.0	58.7	29.7	40.3
Long Term Debt	-	-	-	4,355	-	-	-	0.4
Loans from Shareholders	-	-	-	142,993	-	-	-	11.7
Other	-	-	-	-	-	-	-	-
Total Long Term Liabilities	-	-	-	147,348	-	-	-	12.1
Total Liabilities	657,936	1,029,037	440,100	639,468	57.0	58.7	29.7	52.4
Stockholder's Equity								
Capital Stock	1,000	1,000	1,000	1,000	0.1	0.1	0.1	0.1
Dividend Draw	-	-	-	-	-	-	-	-
Additional Paid in Capital	445,593	767,106	967,106	579,742	38.6	43.7	65.2	47.5
Retained Earnings	49,170	(43,710)	74,411	-	4.3	(2.5)	5.0	-
Other	-	-	-	-	-	-	-	-
Total Equity/Capital (Net Worth)	495,763	724,396	1,042,517	580,742	43.0	41.3	70.3	47.6
Liabilities & Shareholder's Equity	1,153,699	1,753,433	1,482,617	1,220,210	100.0	100.0	100.0	100.0

High points of the analysis are as follows:

- Cash on hand has averaged approximately 47 percent of total assets over the five-year period.
- Accounts receivable totals, as a percentage of sales, has increased modestly over the analysis period, signifying ABC Communications has control of its collectables.
- Inventory increased four-fold in 20XX. This increase is in preparation for a new project.
- Net fixed assets have trended in a narrow range (9 to 14 percent) over the past several years.

- Accounts payables increased significantly in 20XX. This increase is the result of the inventory buildup.
- Long-term debt in 20XX is due almost entirely to a shareholder loan.

5.1.2 Income Statement

The Income Statement shows the financial activities of a business over a specific time period. This information is useful in determining costs associated with sales and operating line item expenses of ABC Communications. Income Statements for years ending December 20XX thru September 30, 20XX were used in their unadjusted form. Exhibit 5-2 presents unadjusted Income Statement analysis.

Exhibit 5-2

Historical Internal Analysis of Income Statement

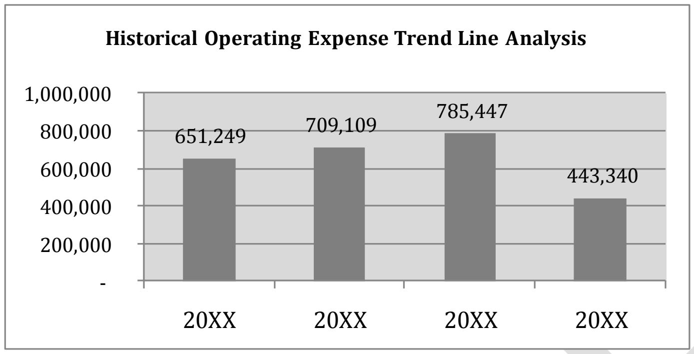
	Source: Income Statement				*Common-size as a % of Gross Revenues*			
	20XX	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**	**20XX**
Months of Operations in Year	*12*	*12*	*12*	*9*	*12*	*12*	*12*	*9*
Gross Sales	2,804,580	3,054,204	2,974,039	2,019,760	100.0	100.0	100.0	100.0
Less: Cost of Goods	2,101,296	2,281,737	1,751,487	1,463,507	74.9	74.7	58.9	72.5
Gross Profit	703,284	772,467	1,222,552	556,253	25.1	25.3	41.1	27.5
Selected Operating Expense Line Items								
Advertising	29,005	38,164	54,456	-	1.0	1.2	1.8	-
Bad Debts	16,393	2,230	28,793	-	0.6	0.1	1.0	-
Owner Compensation	187,573	254,763	275,091	-	6.7	8.3	9.2	-
Payroll	45,191	74,536	88,825	-	1.6	2.4	3.0	-
Travel/Meals/Entertainment	73,633	67,909	73,706	-	2.6	2.2	2.5	-
Misc	299,454	271,507	264,576	443,340	10.7	8.9	8.9	22.0
Operating Expenses	651,249	709,109	785,447	443,340	23.2	23.2	26.4	22.0
Operating EBITDA	52,035	63,358	437,105	112,913	1.9	2.1	14.7	5.6
Less: Depreciation & Amortization	59,211	85,222	49,851	68,085	2.1	2.8	1.7	3.4
Income before Taxes (EBIT)	(7,176)	(21,864)	387,254	44,828	(0.3)	(0.7)	13.0	2.2
Other Income (Expenses)	589	-	-	29,429	0.0	-	-	1.5
Interest (Expenses)	(2,534)	(13,755)	(2,589)	(424)	(0.1)	(0.5)	(0.1)	(0.0)
Pre-Tax Income	(9,121)	(35,619)	384,665	73,833	(0.3)	(1.2)	12.9	3.7
Less: Income Taxes	-	-	-	-	-	-	-	-
Net Income (Loss)	(9,121)	(35,619)	384,665	73,833	(0.3)	(1.2)	12.9	3.7

High points of the analysis are as follows:

- Sales have been similar from one year to the next. Reported sales in 20XX are lower than historic results because the results are based on a nine-month reporting period. Forecasted annual sales for 20XX are approximately $2.6 million. Lower than 20XX by approximately 13 percent. Management provided no explanation for this downturn.

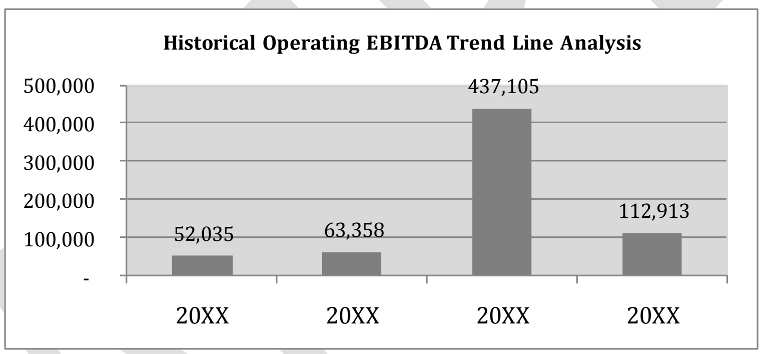
- Gross profit totals as a percentage of sales have been relatively steady.
- Total operating expenses are similar from one year to the next. For the period 20XX thru 20XX selected line items are similar year-over-year. Management states they have

a good handle on expenses. Comparative data for 20XX was lacking due to the lack of tax reporting data as of September 30, 20XX (see table below).



- Pre-tax income has been erratic ranging from a low of 1.2 percent of sales to a high of 12.9 percent. Pre-tax income in 20XX was unusually high due to lower than normal cost of sales.

- Historical earnings before interest, taxes, depreciation and amortization (EBITDA) has been positive over the analyzed years (see table below).



5.2 DuPont Analysis

Generally the "bottom line" or operating profit margins on sales tends to be the most important piece of financial data to which buyer's focus on. Operating profit margins tell, at best, only one-third of the Company's financial performance. For a business to be successful, it must not only produce day-to-day operating profits from sales, it must also effectively manage its level of assets and debt amounts.

A model of analysis was developed to illustrate management's focus on all three critical elements to obtain a good financial position; (i) operating management; (ii) asset management and (iii) capital structure management. This analysis technique is called the DuPont Formula. The DuPont Formula shows the interrelationship between several key financial ratios. As gleaned from Exhibit 5-3, a Return on Investment and Return on Equity were developed for each historical period.

- Return on Investment should be positive and growing over time. This ratio measures the profitability of assets in use by the firm.

- Return on Equity represents the profitability of funds invested by the owners.

Exhibit 5-3

DuPont Analysis				
	20XX	20XX	20XX	20XX
Gross Sales	2,804,580	3,054,204	2,974,039	2,019,760
EBIT	(7,176)	(21,864)	387,254	44,828
Pre-Tax Income	(9,121)	(35,619)	384,665	73,833
Effective Tax Rate	38.5%	38.5%	38.5%	38.5%
Net Income	(5,609)	(21,906)	236,569	45,407
Total Assets	1,153,699	1,753,433	1,482,617	1,220,210
Total Liabilities	657,936	1,029,037	440,100	639,468
Equity	495,763	724,396	1,042,517	580,742
Return on Investment (ROI)	-0.5%	-1.2%	16.0%	3.7%
Return on Equity (ROE)	-1.1%	-3.0%	22.7%	7.8%

ROI or return on invested capital = (net income/ sales)*(sales/total assets)

ROE = (net income/pretax profit)*(pretax profit/EBIT)*(EBIT/sales)*(sales/total assets)*(total assets/equity)

The DuPont Formula allows an appraiser to examine how the Company generates its return on equity. If operating management is strong (high net income) and asset management is strong (high total asset turnover) and capital structure management is strong (appropriate low leverage), then return on equity will be high for sound business reasons and ABC Communications can be said to be in a strong financial position. ROI and ROE have been erratic due to the erratic nature of pre-tax income.

5.3 Financial and Industry Operating Ratios

Ratios are among the best-known and most widely used tools of financial analysis. A financial ratio is a relationship between two quantities on a company's financial statements, which is derived by dividing one quantity by another. The purpose of using ratios is to reduce the amount of data to a workable form and to make it more meaningful. Ratios are tools of analysis that in most cases provide us with clues and symptoms of underlying conditions.

In Exhibits 5-4 and 5-5, the Company data is shown in its unadjusted form and compared against the industry. The data used is from Risk Management Associates (RMA) and is obtained from member banks, which forward their customer financial statements to RMA for compilation.

Exhibit 5-4

Industry Comparative Analysis - Historical					
Line Item	**20XX**	**20XX**	**20XX**	**20XX**	**Industry**
Income Data					
Gross Sales	100.0	100.0	100.0	100.0	100.0
Gross Profit	25.1	25.3	41.1	27.5	0.0
Operating Expenses	23.2	23.2	26.4	22.0	93.0
All Other Expenses (net)	-0.1	-0.5	-0.1	1.4	1.8
Profit before Taxes	-0.3	-1.2	12.9	3.7	5.2
Assets					
Cash & Equivalents	56.1	29.6	54.5	48.1	12.6
Receivables (net)	19.0	45.7	29.3	24.3	15.4
Inventory	1.4	0.9	1.1	4.6	14.1
All Other Current	2.3	11.9	5.9	3.3	3.8
Total Current	78.8	88.2	90.8	80.4	45.9
Fixed Assets (net)	14.5	8.6	9.2	13.7	35.9
Intangibles (net)	0.0	0.0	0.0	0.0	6.5
All Other Non-Current	6.7	3.2	0.0	6.0	11.7
Total	100.0	100.0	100.0	100.0	100.0
Liabilities					
Notes Payable-Short Term	0.0	0.0	0.0	0.0	10.6
Trade Payables	5.0	8.8	9.1	24.3	17.0
All Other Current	52.1	49.9	20.5	16.0	18.7
Total Current	57.0	58.7	29.7	40.3	46.3
Long-Term Debt	0.0	0.0	0.0	0.4	24.8
All Other Non-Current	0.0	0.0	0.0	11.7	5.0
Net Worth	43.0	41.3	70.3	47.6	23.9
Total Liabilities & Net Worth	100.0	100.0	100.0	100.0	100.0

Exhibit 5-5

Industry Comparative Analysis					
Ratios	**20XX**	**20XX**	**20XX**	**20XX**	**Industry**
Current	1.4	1.5	3.1	2.0	1.3
Quick	1.3	1.3	2.8	1.8	0.7
Sales/Receivables	12.8	3.8	6.9	6.8	11.3
Days' Receivables Outstanding	28	96	53	54	32.0
COG/Inventory	129.4	140.5	107.9	25.9	na
Days' Inventory	2	2	2	10	na
COG/Payables	36.8	14.8	12.9	4.9	na
Days' Payables	10	25	28	74	na
Sales/Working Capital	11.2	5.9	3.3	4.1	27.3
EBIT/Interest	-2.8	-1.6	149.6	105.7	2.3
Fixed/Worth	0.3	0.2	0.1	0.3	1.3
Debt/Worth	1.3	1.4	0.4	1.1	2.7
%Profit before Taxes/Tangible Net Worth	-1.8	-4.9	36.9	12.7	11.4
% Profit before Taxes/Total Assets	-0.8	-2.0	25.9	6.1	3.8
Sales/Net Fixed Assets	16.8	20.2	21.8	12.1	6.2
Sales/Total Assets	2.4	1.7	2.0	1.7	1.8
%Depr, Dep, Amort/Sales	2.1	2.8	1.7	3.4	3.7
% Officers Compensation	6.7	8.3	9.2	0.0	6.5

The analysis indicates the following value and risk drivers for ABC Communications:

- ABC Communications' profit before tax was lower than the industry norm in three of the last four years.
- Cash and equivalents are significantly higher than the industry average.
- Accounts receivable are approximately 40 percent higher for ABC Communications versus the industry throughout the four periods analyzed.
- ABC Communications' net fixed assets are less than half of the industry norm over the analysis period.
- ABC Communications' current liabilities and long-term debt is favorable versus the industry norm.
- The Company's equity position in 20XX is 47.6 percent versus 23.9 percent for the industry, which would provide an excellent cushion if the economy stalls.

In summary, the ratio analysis indicates that ABC Communications has a strong balance sheet, including a favorable liquidity position. However, the Subject's profitability has been erratic and below the industry norms. It appears that management has room for improving its operations.

5.4 Quantitative Risk Analysis

A quantitative risk analysis can be performed using Altman's Z-Score formula for private-general businesses[11]. Altman developed this version to predict the likelihood of a privately owned general (manufacturing Model "A" five ratios or non-manufacturing Model "B" four ratios) business of entering bankruptcy. Altman's four and five variables (ratios) for private general businesses with a Z-Score above 2.90 for Model "A" and 2.60 for Model "B" are considered financially healthy, a Z-Score of 1.10 or below is an indicator the business is likely to become insolvent. Likewise, a score between 2.60 and 1.10 demonstrates potential financial trouble and measures should be immediately taken to correct the firm's financial condition.

Based on the financial information contained in this report, a Z-Score risk analysis can be performed. Using the factor formula assigned for private general businesses, the results are shown below.

Exhibit 5-6

Privately Held Company Z-Score Model "B" (Non-Manufacturing)

Account Description	20XX	20XX	20XX	20XX
Months of Operations in Year	*12*	*12*	*12*	*9*
Gross Sales	2,804,580	3,054,204	2,974,039	2,019,760
Operating Income EBIT	(7,176)	(21,864)	387,254	44,828
Working Capital	251,413	517,533	906,382	488,490
Total Assets	1,153,699	1,753,433	1,482,617	1,220,210
Total Liabilities	657,936	1,029,037	440,100	639,468
Retained Earnings	49,170	(43,710)	74,411	-
Net Worth (Equity)	495,763	724,396	1,042,517	580,742
Total Z-Score	2.2	2.6	8.3	3.8

The analysis reveals Z-Scores right at or above the 2.60 (Model "B") financially healthy threshold for the last three years. As can be gleaned from the above data, ABC Communications is in a low risk category and could reasonably be expected to operate into the future.

The one drawback in using a ratio-based formula for risk analysis is that, ratios are based on historical accounting figures; and results can be meaningless in a fast changing economy and industry.

5.5 Adjustments to the Financial Information

Frequently, the valuation of closely held companies requires adjusting the historical balance sheets and income statements for GAAP adjustments and/or to eliminate items such as non-operating assets and non-recurring or unusual income or expenses. Adjustments are made to create adjusted (normalized) financial statements to assess trends within the financial statements and among different periods. Adjustments are made to create a financial picture more representative of management maximizing the earnings potential of the business.

[11] See "Z-Score Risk Analysis Tool" written by KC Conrad, Fall Edition of Business Appraisal Practice.

5.6 Balance Sheet Adjustments

Our valuation date is September 26, 20XX, the date of Mr. Eric Holder's death. As mentioned earlier, we accepted the balance sheet as of September 30, 20XX, as management indicated there were no material changes within this short time difference.

We made the following adjustments to the September 30, 20XX historical balance sheet.

- **Cash.** A review of the Subject's historical balance sheets indicates the Subject's cash balance has ranged from 29.6 to 56.1 percent of total assets. The most recent year at 48.1 percent is in the range of the previous four years cash balances. We believe the Subject's cash balance is in excess of normal operating requirements. Therefore, we have adjusted the cash balance to approximately 12 percent ($470,000) of the adjusted assets, which is equal to the industry average. The adjustment of $470,000 will be added back, as excess cash, in the reconciliation section of this report.

- **Property and Equipment.** We adjusted the individual property and equipment accounts from book value to an estimated remaining economic life balance. For example, we estimated automotive equipment has an estimated economic life of 5 years and a remaining useful life of 2 years. Therefore, we reduced the book balance of automotive equipment by 60 percent (3 years expired life / economic life). We made similar estimates for each of the property and equipment accounts. Shown below are the estimated economic life and remaining useful life for each of the property and equipment line items.

	Economic Life		
	Total Years	Remaining	Expired
Automotive	5	2	3
Airplane	15	0	15
Communications equipment	5	2	3
Computer equipment	5	2	3
Furniture and equipment	7	3	4
Buildings	40	5	35
Shop tools	7	3	4
Software	7	3	4
Test equipment	5	2	3
Trailers	5	2	3

Note: Separate valuations of the Subject Company's individual assets, such as shop equipment and office furniture and equipment, were beyond the scope of this report and were not performed for this valuation. However, if a separate asset valuation was performed we believe the asset values would most likely fall within a reasonable range of our estimated economic life values presented herein.

- **Accumulated Depreciation**. We have adjusted fixed assets to reflect their estimated economic value. Therefore, depreciation is added back on the adjusted balance sheet.

- **Other Line Item.** We have removed this line item because it is a receivable to two shareholders for which there is no documentation as to whether it will be repaid.
- **Trapped-In Capital Gains.** The Subject has appreciated assets subject to capital gains taxes. A company that holds an appreciated asset has to pay a capital gains tax on the sale of the asset should the company elect to sell it. In this case we did not adjust the balance sheet for capital gains tax because there have been no sales of the Subject's assets in the last five years; management is not considering the sale or liquidation of the Subject; there are no Articles of Incorporation, Bylaws, Shareholder Agreements, or other legal documents, which could force the sale of the Subject or a substantial portion of the assets; and the ownership interest being valued cannot force the sale of the Subject.
- **Off-Balance Sheet Assets and Liabilities.** In some companies, there may be off-balance-sheet assets or liabilities or contingent liabilities not represented on the company's financial statements. American Business Appraisers was provided a copy of a real estate appraisal performed by Andy Guessing of ABC Real Estate Appraisers for vacant land located at 1234 Bell Rd., Arizona. According to the appraisal report, ABC Communications is listed as "Owner of Public Record". An adjustment is required to reflect the value ($2,000) of the vacant land as reported in the real estate appraisal report. This adjustment will be added as a non operating asset in the reconciliation section of this report.
- **Total Equity.** As a result of the above adjustments, the total stockholders' equity of the Subject Company is reduced from $1,220,210 on the historic September 30, 20XX balance sheet to $893,410 on the adjusted balance sheet, absent any assigned value for the Subject's intangible assets.

The adjusted balance sheet for September 30, 20XX is shown in Exhibit 5-7. This normalized balance sheet will be used in the adjusted book value method, which is presented later in this report.

Exhibit 5-7

Normalized Balance Sheet			
Balance Sheet Item	Historical	Adjusted	Normalized
Cash	586,392	(470,000)	116,392
Receivables	297,039	-	297,039
Inventory	56,515	-	56,515
Other	40,664	-	40,664
Total Current Assets	980,610	(470,000)	510,610
Automotive	300,401	(180,241)	120,160
Airplane	20,852	(20,852)	-
Communications equipment	407,863	(244,718)	163,145
Computer equipment	32,011	(19,207)	12,804
Furniture and equipment	33,364	(19,065)	14,299
Buildings	1,732	(1,516)	217
Shop tools	727	(415)	312
Software	40,290	(23,023)	17,267
Test equipment	126,554	(75,932)	50,622
Trailers	9,937	(5,962)	3,975
Total FF&E Assets	973,731	(590,931)	382,800
Total Accum Depreciation	(807,071)	807,071	-
Net FF&E Assets	166,660	216,140	382,800
Intangible Assets	-	-	-
Other	72,940	(72,940)	-
Total Fixed Assets	1,220,210	(326,800)	893,410
Short Term Debt	-	-	-
Payables	297,115	-	297,115
Other	195,005	-	195,005
Total Current Liabilities	492,120		492,120
Long Term Debt	4,355	-	4,355
Loans from Shareholders	142,993	-	142,993
Other	-	-	-
Total Long Term Liabilities	147,348		147,348
Total Liabilities	639,468		639,468
Capital Stock	1,000	-	1,000
Dividend Draw	-	-	-
Additional Paid in Capital	579,742	-	579,742
Retained Earnings	-	-	-
Other	-	-	-
Total Equity/Capital (Net Worth)	580,742	(326,800)	253,942
Liabilities & Shareholder's Equity	1,220,210		893,410

5.7 Income Statement Adjustments

Discussions with management and the appraiser’s review of the financial information indicated one adjustment to the income statements was necessary. Management indicated there were no personal items charged against the Company's earnings. We made the following adjustment to the historical income statements.

- **Airplane Expense.** Airplane expenses were considered a non-operating expense and were removed from operating expenses.

The adjusted income statements for the period December 31, 20XX through September 30, 20XX are shown in Exhibit 5-8. These adjusted income statements will be used in the discounted future earnings, adjusted book value, and direct market data methods, which are presented later in this report.

Exhibit 5-8

Normalized Pre-Tax Income				
	20XX	**20XX**	**20XX**	**20XX**
Months of Operations in Year	*12*	*12*	*12*	*9*
Gross Sales	2,804,580	3,054,204	2,974,039	2,019,760
Less: Cost of Goods	2,101,296	2,281,737	1,751,487	1,463,507
Gross Profit	703,284	772,467	1,222,552	556,253
Operating Expenses	710,460	794,331	835,298	511,425
Operating Income (EBIT)	(7,176)	(21,864)	387,254	44,828
Interest (Expenses)	(2,534)	(13,755)	(2,589)	(424)
Other Income (Expenses)	589	-	-	29,429
Pre-Tax Income	(9,121)	(35,619)	384,665	73,833
Normalized Adjustments to Pre-Tax Income				
Airplane expense	8,197	13,317	10,949	5,966
Normalized Pre-Tax Income	(924)	(22,302)	395,614	79,799

5.8 Growth Expectations

The appraiser develops a long-term sustainable growth in earning power for the Subject based upon an analysis of local, regional, and national economic conditions as they affect the business and industries in which the Subject competes.

The growth rate assumption is not necessarily ABC Communications' expected growth rate next year, but rather what can be expected for the long-term growth expectation based upon a fundamental understanding of the business and the industry it competes within. The long-term growth rate for earnings is an average of future growth rates in cash flow and not one expected to occur every year into perpetuity. Some of the Subject's growth years will be higher or lower, but the expectation is that future long-term growth will represent the average over time. It is also essential to understand that the determination of a sustainable growth rate depends upon the base of assumed ongoing earning power.

In the appraiser's view, is the principal driver of long-term sustainable growth for ABC Communications is growth in the general level of economic activity in its market. The best indicator of this growth is a combination of projected changes in inflation and real growth in GDP tempered by forecasts of growth for the specific industry in which the Subject operates, and the expected performance of the Subject in that industry setting.

The economic forecasters (Exhibit 3-1) are predicting that inflation rate will be about 2.3% per year beyond 20XX and the growth in the GDP is expected to be 2.6% per year. Based on this projection and the analysis of the state and local economic trends, which generally mirror the national trends, the sum of projected growth, 2.3% and the inflation rate, 2.6% combine to suggest growth in economic activity of about 4.9% per year. However, due to differences between the Subject and industry, the Subject's geographic location, and the local area economic outlook, we believe the Subject's projected long-term growth rate will be approximately 3 percent, consisting of an inflation rate of 2.5 percent and real growth of .5 percent.

5.9 Projected Income Statements

In preparing the preceding financial projections, we made various assumptions about expected future revenues and expenses. These assumptions were made after gathering and analyzing data that affects the future economic outlook of ABC Communications. This section of the report provides a broad overview of the projections of ABC Communications and has been prepared to emphasize items considered significant to the overall understanding of the projections.

The reader is reminded 20XX is a partial year (9 months). The appraiser has annualized ABC Communications' 20XX data to use as a basis for our forecast period. Exhibits 5-9 and 5-10 illustrate, in detail, the sales and cost of goods categories used in our forecast. These exhibits are included to allow the reader to understand how the numbers were derived.

Exhibit 5-9

Sales Forecast

	Annualized	*As of December 31st*			
	20XX	**20XX**	**20XX**	**20XX**	**20XX**
Sales A	448,780	462,243	476,111	490,394	505,106
Sales B	1,293,613	1,332,421	1,372,394	1,413,566	1,455,973
Sales C	339,865	350,061	360,563	371,380	382,521
Sales D	7,540	5,655	4,241	3,181	2,386
Sales E	603,215	621,300	639,951	659,150	678,925
Sales F	-	700,000	900,000	600,000	-
Total	2,693,013	3,471,681	3,753,260	3,537,670	3,024,910

Exhibit 5-10

Cost of Goods Forecast

	Annualized	*As of December 31st*			
	20XX	**20XX**	**20XX**	**20XX**	**20XX**
Sales A	401,372	413,413	425,816	438,590	451,748
Sales B	233,646	240,655	247,875	255,311	262,971
Sales C	935,923	964,001	992,921	1,022,708	1,053,390
Sales D	10,835	6,501	3,901	2,340	1,404
Sales E	369,566	380,857	392,290	404,059	416,181
Sales F	-	322,000	414,000	276,000	-
Total	1,951,342	2,327,427	2,476,802	2,399,009	2,185,693

Our projections are based upon the analysis of historical calendar year-end December 31, 20XX through December 31, 20XX and the annualizing of partial period ending September 30, 20XX. Shown below is a summary of the significant assumptions used in our forecasts.

- **Sales**: We have forecast sales as being a function of volume growth and average price change. Most sales categories have been forecasted at an overall increase in average price of 3 percent, except the blank category. Historical data shows blank sales have been in decline since 20XX, which was $40,794 at the high point. In 20XX, blank sales were $11,034. The appraiser believes blank sales will continue the declining trend, which is reflected in our forecast. The seaback project represents a $2.2 million dollar grant from the Federal Government, associated with digital communications. Management stated this project needs to be “up and running” by January 1, 20XX, which is spread out over a three-year period (20XX-20XX).
- **Cost of Goods**: Historically, cost of goods has averaged approximately 70 percent over the look back period. Cost of goods is estimated to fluctuate somewhat below the historical average in 20XX through 20XX, and then increasing to approximately 72 percent in 20XX. The lower cost of goods in 20XX through 20XX is due to the increased profit margin (per management), associated with the backbone project.
- **Operating Expenses**: Operating expenses are forecasted at 23 percent over the analysis period. This rate is lower than the historical average. We forecasted a lower expense ratio due to the spreading of expenses over a higher sales volume and the reduction in owner compensation expense associated with Mr. Holder.

The Subject Company’s forecasted earnings before interest and taxes (pre-tax), for the period 20XX through 20XX, is shown in Exhibit 5-11.

Exhibit 5-11

Forecast EBIT

	Adjusted	*As of December 31st*				Terminal
	Annual 20XX	20XX	20XX	20XX	20XX	Year
Revenue Growth Rate		*28.9%*	*8.1%*	*-5.7%*	*-14.5%*	*3.0%*
Gross Sales	2,693,013	3,471,681	3,753,260	3,537,670	3,024,910	3,115,658
Cost of Goods	1,951,342	2,327,427	2,476,802	2,399,009	2,185,693	2,257,588
Gross Profit	741,671	1,144,254	1,276,458	1,138,662	839,217	858,070
Operating Expenses	673,853	798,487	863,250	813,664	695,729	716,601
Operating Income (EBIT)	67,818	345,767	413,208	324,997	143,488	141,468
EBIT as a Percentage of Sales	*2.5%*	*10.0%*	*11.0%*	*9.2%*	*4.7%*	*4.5%*

Note: The financial information presented above includes normalization adjustments made solely to assist in the development of the value conclusion presented in this report. This information should not be used to obtain credit or for any purpose other than to assist in this valuation, and we express no opinion or other assurances on this presentation.

5.9.1 Financial Implications to Subject’s Business

Sales are forecast to increase through 20XX due to a Federal Government contract, but will return closer to historical levels after completion of the contract in early 20XX. Expenses have been trending upward, which could be due to an expectation of revenue growth. The biggest concern is the Subject's erratic profitability. This appraiser's summary analysis of the financial conditions implies the following:

- Growth in sales should very likely continue at a moderate rate for the near term, and then return to more historic levels.
- Profit Margins (i.e., operating) guarded to moderate.
- Borrowing Costs (i.e., interest rates) are likely to remain low for the interim period.
- Business Risk (i.e., volatility of operating income) high.
- Financial Risk (i.e., likelihood of bankruptcy) low.

6 Valuation Methodologies

After we collected the information received from the Subject and obtained information from our own sources, we analyzed this information so as to be able to select those approaches and methods of valuation applicable to this assignment.

A valuation approach is a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods. The three primary approaches in determining the market value of closely held companies are the income, market, and asset approaches.

The income approach has its theoretical basis in the Principle of Future Benefits - economic value reflects anticipated future benefits. This approach estimates value by considering the economic income (future benefits) accruing to the Subject's owner over a period of time.

The market approach has its theoretical basis in the Principle of Substitution, which states the economic value of a thing tends to be determined by the cost of acquiring and equally desirable substitute. Equally desirable does not mean identical. It means equally desirable from an ownership or investment standpoint.

The asset approach has its theoretical basis in the Principle of Substitution, which is based on the proposition the informed purchaser will pay no more than the cost of producing a substitute business with the same utility as the Subject. This approach uses various methods that consider the value of individual assets, including intangible assets, and liabilities.

Within valuation approaches there are valuation methods, which are a specific way to determine value. We considered all generally accepted valuation methods.

6.1 Valuation Methods Considered But Rejected

The following valuation methods were considered but rejected for this valuation.

- **Capitalization of Earnings Method.** The capitalization of earnings method is used to convert some normalized level of ongoing benefit into a present value based on a single period. This method is most appropriate when the following criteria are present in the Subject entity: a relatively stable level of income or cash flow, increasing at a relatively constant rate, for a relatively long period. In this case, the above criteria did not apply. Therefore, we did not use this method.

- **Dividend-Paying Capacity.** Dividend-paying capacity is the amount available to pay dividends to owners after allowing for the cash and capital needs of the company. This method is advocated in Revenue Ruling 59-60. We did not explicitly use this method; however, consideration of the dividend-paying capacity of the Subject Company is incorporated in the net cash flow income stream in the application of the income approach.

- **Guideline Public Company Method.** The guideline public company method uses financial data from publicly traded companies to develop an indicated value for the Subject Company. Guideline public company valuations are based on the actual price investors have paid for minority interests in companies in the same or similar line of business as the Subject. We identified five publicly traded companies in the same industry as the Subject. However, this method was rejected because these companies were significantly larger than the Subject.

- **Prior Transactions in the Subject Company.** The prior transaction method is one of the most reliable methods for valuing a closely held business, if the information is available. This method requires the prior transactions were made under economic circumstances similar to those on the valuation date and they were at arm's-length. During the five years before the valuation date there were no sales of the Subject Company's stock or any offers to purchase the Subject's stock or a significant portion of the Subject Company's stock. Therefore, we did not utilize this method.

- **Book Value.** Book value is the cost at which an asset is carried on the balance sheet. Book value is based on the historical cost of a company's assets and may vary significantly from fair market value. Book value assumes liquidation, which is inappropriate for a going concern. Therefore, we did not utilize book value.

- **Liquidation Value Method.** Liquidation value is the net amount realized if the business is terminated and the assets sold piecemeal. This method assumes the discontinuance of the Subject, which is inappropriate for a going concern. In this valuation, our opinion of fair market value assumes the assets are installed, in place, ready for continued use and is part of a going concern business entity. Therefore, we did not utilize this method.

6.2 Valuation Methods Selected

We selected the following methods as the most appropriate methods for estimating the fair market value of a one-percent voting share in ABC Communications; (i) Discounted future earnings method; (ii) Direct market data method and (iii) Adjusted book value/excess earnings methods. The following sections of this report will describe these methods and utilize them to calculate the fair market value of a one-percent voting interest in ABC Communications.

6.3 Income Approach

Income methods are earnings, or cash flow based, and are calculated on a forward looking basis, then a risk-related rate of return is determined and applied to earnings or cash flows to estimate the fair market value of the Company. When an income approach is used to determine fair market value, goodwill is inclusive in the indication of value.

6.3.1 Discounted Future Earnings Method

We believe the most appropriate income method in this case is the discounted future earnings method. The discounted future earnings method is appropriate in this case because the Subject is experiencing an unstable level of earnings or cash flow and/or non-constant growth rates.

The underlying premise of the discounted future earnings method is the basic valuation principle that an investment in a business is worth the present value of all the future benefits it will produce for the owner(s). Therefore, when dealing with future benefit flows, it is necessary to reduce the future stream of income to a common denominator, which reflects the fact that a given sum of money becomes less valuable the greater the number of years it is removed from the present. This is accomplished by discounting a selected future benefits stream. The future benefits stream selected to estimate value is pre-tax earnings available to invested capital (as if debt free). This earnings stream was selected because it is the best proxy considering the available financial information.

6.3.2 WACC Discount Rate

The discount rate used in this analysis was based on the Subject's weighted average cost of capital ("WACC"). Our estimate of an appropriate WACC discount rate consists of the following components: equity pre-tax discount rate; cost of debt; and the weighted average of debt and equity costs.

6.3.3 Equity Pre-Tax Discount Rate

The fundamental premise underlying the selection of a pre-tax discount rate of return is that the return required by an investor, in the Subject Company, is the sum of the rate required by investors in risk-free securities and a theoretically derived equity risk premium. A pre-tax equity discount rate can be developed by using information compiled by Duff & Phelps, LLC[12] which utilizes specific financial components of the Company's historical performance. Exhibit 6-1 presents the Company's equity discount rate applicable to pre-tax income.

Exhibit 6-1

Equity Rate of Return Development

	Subject's	Subject's	*Duff & Phelps Risk Premium*		
	Data $mil's	Logarithm	Slope	Constant	ERP
Book Value of Equity	$ 0.58	-0.236	-2.863	15.190	15.9
Four-Year Average Net Income	$ 0.10	-0.985	-2.656	12.729	15.3
Total Assets	$ 1.22	0.086	-2.732	15.804	15.6
Four-Year Average EBITDA	$ 0.17	-0.779	-2.606	13.723	15.8
Gross Sales	$ 2.69	0.430	-1.983	15.218	14.4
Number of Employees	11	1.041	-1.934	16.048	14.0
Median Equity Risk Premium					15.5
Riskless Rate *(as of the valuation date)*					4.7
Specific Company Risk Adjustment					5.0
Management Depth				3	
Customer Concentration				1	
Systems and Procedures				1	
Subject's Equity Net Cash Flow Discount Rate					25.2
Long-Term Sustainable Growth Rate					(3.0)
Subject's Equity Net Cash Flow Capitalization Rate					22.2
Net Cash Flow to Net Income Conversation Factor					1.05
Subject's Equity Net Income Capitalization Rate					23.3
Divided by One Minus Tax Rate					0.63
Subject's Equity Pre-Tax Capitalization Rate					35.2
Long-Term Growth Rate					3.0
Subject's Equity Pre-Tax Discount Rate					38.2

We reviewed each of the calculated equity risk premiums to identify any unusually high or low premium. Our review indicated no adjustments were necessary. The calculated equity risk premiums ranged from 14.0 to 15.9 percent with a median of 15.5 percent. We selected the median of 15.5 percent as the being an appropriate equity risk premium in this case.

[12] Duff & Phelps, LLC, *Risk Premium Report*

Six components were utilized to develop an equity risk premium (ERP) for the Company. This equity risk premium is added to the risk-free rate *(as of the valuation date)*, followed by the specific company risk premium adjustment to develop an equity discount rate applicable to net cash flow. A risk-free rate of return is the return available to investors on a low-risk guaranteed investment, an investment generally considered as being free of default. The financial community typically uses the yield to maturity of long-term Treasury bonds as a proxy for the risk-free rate. In this analysis we utilized the long-term (20-year) U.S. Treasury bond yield. At the date of valuation the yield required by investors in government securities was 4.7% (Source: St. Louis Federal Reserve Bank).

We believe the Subject Company's risk characteristics are similar to the average benchmark company in terms of geographical diversity; customer mix and reliance; supplier mix and reliance; quality of variability of earnings; coverage, liquidity; financial leverage; and strength and duration of banking relationships. We believe the Subject Company has more risk than the average benchmark company in terms of:

- **Management Depth.** ABC Communications lacks management depth. This increases risk and justifies an increase in the specific-company risk premium. We have added an additional three-percentage points as a proxy for this risk factor.

- **Customer Concentration**: The Subject is dependent on three customers for 35 percent of its revenue. However one of these customers is the U. S. Air Force (accounting for 25 percent), for which our Subject is the "sole source" custom manufacturer of UMTE interface kits. We have added an additional one-percentage point as a proxy for this risk factor.

- **Limited Systems and Procedures**. The Subject lacks efficiencies in customer service, processing/systems could be better, and management states there are gaps in the current phone system. Weaknesses in these areas have the potential to adversely impact future sales. Therefore, we have added an additional one-percentage point as a proxy for this risk factor.

Given the preceding discussion, we believe the best estimate of a specific-company risk premium for the Subject Company is 5 percent. Using the rates discussed above, we have calculated an equity pre-tax discount rate of 38.2 percent as being appropriate for this valuation assignment.

The equity discount rate reflects the time value of money, inflation, and the risks associated with ownership of the specific business or business interest that is the Subject of this valuation assignment.

6.3.4 Weighted Average of Debt and Equity Cost

In this valuation we used the current invested capital mix based on the Subject's normalized balance sheet.

Exhibit 6-2

Weighted Average Cost of Capital (WACC)				
Cost of Pre-Tax Equity (Exhibit 6-1)				38.20%
Cost of Debt (Prime + 2)				5.25%
FMV Balance Sheet Line Items				
Assets		Liabilities & Equity		
Current Assets	510,610	Current Liabilities		492,120
Net Fixed Assets	382,800	Interest Bearing Debt		147,348
Other Assets	-	Equity		253,942
Total	893,410	Total		893,410
Capital Structure				
Equity				28.4
Debt				71.6
Computation of WACC				
Component		Net Rate	Ratio	Calculation to WACC
Debt @ Borrowing Rate		5.3%	71.6	3.8
Equity Rate (Discount Rate)		38.2%	28.4	10.9
WACC Applicable to Pre-Tax Invested Capital *(Discount Rate)*				14.6
		Long-Term Growth Rate		(3.0)
WACC Applicable to Pre-Tax Invested Capital *(Capitalization Rate)*				11.6

6.3.5 WACC Capitalization Rate

Our estimation of ABC Communications' continuing value is based on an 11.6 percent direct capitalization rate. This direct capitalization rate was derived from the WACC discount rate of 14.6 percent less an expected long-term growth rate of 3 percent.

6.3.6 Continuing Value

We estimated the value of ABC Communications at the end of the discrete forecast period by capitalizing 20XX's EBIT earning stream as an annuity in perpetuity.

6.3.7 Mid-Year Discounting Adjustment

The basic capitalization formula, when using the discounted future earnings method, assumes the cash flows are received at the end of each year. However, in this case it is reasonable to assume the cash flows occur continuously throughout the year rather than at the end of the year. To accommodate this assumption, we increased value by a mid-year adjustment factor.

6.3.8 Summary and Indicated Value

The Market Value of Invested Capital (MVIC) was determined by adding the present values of the cash flows for the forecasted five future years and the continuing value. We then subtracted total interest-bearing debt. The indicated value is on a control interest, as if freely traded marketable basis. An adjustment will be required to convert the freely traded basis into a closely held basis. This will be discussed in the reconciliation section of the report.

Exhibit 6-3

Discounted Future Earnings Method - Invested Capital Model							
Selected Year	Projected EBIT	WACC Discount Rate	Present Value Factor	Mid-Year Convention	Converted PV Factor	WACC Capitalization Rate	Present Value
20XX	$ 345,767	0.146	0.873	0.50	0.934		322,992
20XX	$ 413,208	0.146	0.761	1.50	0.815		336,815
20XX	$ 324,997	0.146	0.664	2.50	0.711		231,163
20XX	$ 143,488	0.146	0.580	3.50	0.621		89,057
Terminal Year	$ 141,468	0.146	0.580	3.50	0.621	0.116	756,930
						Market Value of Invested Capital	1,736,957
						Less: Interest Bearing Debt	(147,348)
						FMV of 100% Equity Interest on a Controlled, Freely Traded Basis	1,589,609

6.4 Market Approach

The market approach includes a collection of methods which uses transactional data of actual sales from the market. The general theory is that if one can find sufficiently similar companies that have been sold in an arm's-length transaction, those transactions may form a foundation for an indication of value. Considerations in looking at market transactions include the following:

- Were terms of the transactions sufficiently similar?
- Were the companies that sold, or in which interests were sold, sufficiently similar to the company in which the Subject interest is held?
- Were the buyers sufficiently motivated?
- Were motivations of actual buyers in these transactions similar enough to allow the transactions to be relevant in the context of "equally desirable substitutes"?
- Were buyers in those transactions financial buyers inherent in the definition of fair market value or strategic buyers inherent in the definition of investment value?

6.4.1 Direct Market Data Method

We believe the most appropriate market-based method in this case is the direct market data method. The direct market data method examines the prices paid for closely held companies that are engaged in a similar line of business as the Subject.

6.4.2 Selection of Closely Held Transactions

As part of our analysis we searched for the prices paid for minority shares of publicly traded companies. We searched for companies using the American Association of Individual Investors Stock Investors database, with fundamental stock data on approximately 8,660 stocks. Our search criteria included the following:

- SIC code 4812: Wireless Telecommunications Services
- SIC code 4899: Telecommunications Services
- Sales of less than $15 million
- Companies incorporated in the United States

Base on these criteria no publicly traded companies were identified. Therefore, we did not use this method.

We then searched the IBA Market Database ("IBA Data") for sale transactions of closely held companies in the selected NAICS (SIC) codes. IBA Data utilizes sold transactional data, which represents the market as a whole. These transactions provide an independent source of comparable sale information that may be used with market data methods or at the very least, used as a benchmark for reasonableness checks.

Our initial search identified 55 transactions of companies in the same or similar line of business as the Subject, with annual gross sales ranging from $36,000 to $14 million.

> *Note: A study performed by Ray Miles indicated that there needs to be at least ten transactions similar to the Subject to measure the overall market.*

6.4.3 Nature and Limitations of Direct Market Data

We considered the following items while analyzing the IBA's data:

- Transactions are based on actual sales of 55 other businesses. These businesses are of varying size; however, each is involved in telecommunications services.
- Detailed information concerning the business being sold (for example: product mix, capitalization, growth rate, etc.) was not available and transaction data was not independently verifiable.
- Transactions are from more than one state or region in the United States and in some cases the geographical location is not identified. A review of the data does not indicate a geographical bias or sensitivity.
- Transactions cover a time period from 19XX through 20XX. One concern with this time period is the question of age. Does time affect the usefulness or reliability of the data? A study of the IBA's database by Raymond C. Miles, Executive Director of the Institute of Business Appraisers, attempted to determine if various time periods affected the sales price to gross sales and/or sales price to annual earnings multiples. Mr. Miles conclusion was the multiples did not appear to be time sensitive. Therefore, we determined these multiples could be used in developing an informed opinion of value.
- The database may contain erroneous entries and result in "outlier" transactions. An outlier is a data point that is so far from the central position of the data distribution as to seem not to belong. Outliers can occur in any situation in which data is gathered for statistical analysis, and for any of a variety of reasons. In transaction data such as in the

IBA Market Database, outliers can occur from any one of a combination of reasons: (1) errors in reporting transaction data, (2) errors in data entry, (3) transactions that are accurately reported but are not arm's-length transactions, and (4) transactions in which either the buyer or seller were not typically motivated. However, if an outlier can be identified as a data point that exists as a result of one of the causes discussed above, it generally can be discarded without distorting the data.

After analyzing the data in the initial search, we refined our search to include companies with annual gross sales in the range of $900,000 to $9 million. We believe companies with gross sales in this range, would operate in a similar fashion when comparing to our Subject Company. This pared-down search revealed 13 transactions with a P/G ratio range of 0.09 to 0.83. The average P/G ratio is 0.38, with a coefficient of variance (measure of relative dispersion of an array of numbers) is 0.54. The lower the coefficient of variance, the tighter the dispersion of numbers. Exhibit 6-4 shows the thirteen transactional data meeting our pared-down search criteria

Exhibit 6-4

Private Transactional Data

Transactions	SIC	Gross Sales (000's)	Sold Price (000's)	Price/ Gross Sales Ratio (P/G)
1	4812	8,602	5,000	0.58
2	4812	6,000	5,000	0.83
3	4812	1,997	649	0.32
4	4899	1,718	922	0.54
5	4899	1,718	922	0.54
6	4899	1,677	275	0.16
7	4812	1,668	365	0.22
8	4899	1,323	125	0.09
9	4812	1,150	306	0.27
10	4899	956	440	0.46
11	4899	953	185	0.19
12	4812	945	287	0.30
13	4899	922	411	0.45
		Range	High	0.83
			Low	0.09
	Mean	2,279	1,145	0.38
	Median	1,668	411	0.32
			Standard Deviation	0.21
			STD/Mean equals Coefficient of Variance	0.54
			Selected Valuation Multiple	0.36

6.4.4 Selection of the Price to Gross Sales Multiple

To select an appropriate P/G ratio to use in this method, the appraiser must decide where, in the range of market values, ABC Communications belongs; considering the comparison of ABC Communications' financial statements with the industry composite. In particular, we relied on the financial analysis presented early in this report. The appraiser considered several *value* drivers that would increase the valuation multiple from the mean, based on the indications in the financial analysis; (i) long-term debt was non-existent for the majority of the look-back period and is well below industry norms, (ii) the Subject's net worth is almost double the industry average in the most current period and has remained above the industry during the look-back period, signaling a strong financial position.

The appraiser also considered several *risk* drivers that would decrease the valuation multiple from the mean, based on the financial analysis; (i) the Subject is less profitable than the industry average; (ii) fixed assets appear to be aged versus their industry peers; and (iii) accounts receivable are higher than the industry.

After consideration of all the data presented above, we selected a P/G ratio of 0.36, slightly below the mean, as appropriate for ABC Communications, Inc. In the case of ABC Communications, the low percentage profitability is an important indicator for selecting a multiple slightly below the industry mean.

6.4.5 Summary and Indicated Value

The indicated value was determined by multiplying the Company's 20XX forecasted gross revenues by the selected P/G ratio. Our initial indication of value is applicable to invested capital. However, in arriving at an opinion of value in contemplation of an *actual* sale, an adjustment to the indicated value is required.

Sales of closely held businesses typically include inventory, fixed assets, and goodwill. Accordingly, to arrive at an estimated fair market value of stockholders' equity, using IBA Data, it is necessary to add cash, accounts receivable and prepaid expenses, and interest bearing debt. Exhibit 6-5 illustrates the indicated value of equity interest on a control, closely held basis, as of September 26, 20XX.

Exhibit 6-5

Direct Market Data Method		
Price/Gross Sales Valuation Multiple		
Application of the P/G Ratio	Revenues	Valuation Multiple
	$ 3,471,681	0.36
Initial Indicated Value		$ 1,249,805
Adjustments to Equity		
Less: Interest Bearing Debt		(147,348)
Plus: Cash		116,392
Plus: Accounts Receivable		297,039
Plus: Pre-paid Expenses		40,664
FMV of Equity on a Control, Closely-Held Basis		$ 1,556,552

6.5 Asset Approach

The asset approach has its theoretical basis in the Principle of Substitution, which is based on the proposition that an informed purchaser will pay no more than the cost of producing a substitute business (asset) with the same utility as the Subject. This approach adjusts all assets and liabilities, both tangible and intangible, to their fair market value. The adjusted value reflects an appropriate premise of value, generally going concern or liquidation.

6.5.1 Adjusted Book Value /Excess Earnings Method

We believe the most appropriate asset-based method, in this case, is the adjusted book value method. In arriving at an indication of value using the adjusted book value method we will use a two-step model. First, tangible assets will be revalued to current fair market value, as nearly as can be estimated. Then, the value of intangible assets will be estimated by applying the excess earnings method. The excess earnings method of valuation is widely used for measuring the goodwill or intangible value of a business.

6.5.2 Rate of Return on Tangible Assets

The tangible asset value used in this analysis was based on the adjusted balance sheet for September 30, 20XX (see Exhibit 5-7). Tangible asset value is defined as the normalized total fixed assets. Factors we considered in selecting a rate of return on tangible assets included the following:

- We calculated the required rate of return on tangible assets based on the Subject's available borrowing capacity. The Subject's tangible assets were analyzed to determine the amount a company could borrow based on the available collateral.
- The forecasted 5.25 percent borrowing rate is based on the prime rate plus 2 percent.

Exhibit 6-6

Adjusted Tangible Assets - Invested Capital Rate

Borrowing Capacity	Adjusted FMV	Percentage Financeable	Borrowing Capacity
Accounts Receivables	297,039	60%	178,223
Inventory	56,515	50%	28,258
Other	40,664	20%	8,133
Adjusted Fixed Assets	382,800	50%	191,400
FMV of Borrowable Assets	777,018		
Borrowing Capacity to Loan			406,014
Debt/Equity Blended Mix			
Fair Market Value of Collateral Assets		100%	777,018
Capacity to Loan		52%	406,014
Equity Balance		48%	371,005
Rate on Debt			
Required Return on Debt	5.25%	52%	2.7%
Required Return on Invested Capital			
Rate of Return (WACC Cap)	11.6%	48%	5.5%
Weighted Rate of Return on Tangible Assets *(Yield Rate)*			8.3%

6.5.3 Excess Earnings

Excess earnings are those over and above the earnings needed to provide a reasonable return on the identifiable tangible assets of the business. The extent by which a company has earnings in excess of the expected level of earnings is attributed to intangible assets (e.g., customer lists, patents, copyrights, goodwill). Excess earnings are calculated by subtracting the earnings stream attributable to tangible assets from the current year invested capital earnings stream.

6.5.4 Capitalization of Excess Earnings

The value of intangible assets is determined by dividing the excess earnings by a capitalization rate. Excess earnings should be capitalized at a rate commensurate with the risks of the business. However, it is difficult to derive an overall capitalization rate for excess earnings from the market. Therefore, we considered several factors in selecting the rate of return required on intangible assets.

- When selecting a capitalization rate for the excess earnings, it must be noted that this component of the overall earnings has the highest risk in that there are no tangible assets (such as land, buildings, or working capital) to back them up. A single digit rate is used for tangible assets, then a higher rate must be used for intangible assets.
- By definition, the intangible assets capitalization rate must be higher than the capitalization rate for the Subject's overall net cash flow rate of return, because if the Subject were to experience any downturn in operations, excess earnings would be lost first. Therefore, we would expect the capitalization rate for excess earnings to be higher than the overall equity rate of return for the Subject.
- The economic stream we selected to capitalize was a pre-tax earnings stream.

Our estimate of the Subject's capitalization rate for intangible assets is based on the level of tangible assets held by the Subject Company. Generally, as tangible asset levels decrease, a higher intangible asset rate of return is required and as tangible asset levels increase, a lower intangible asset rate of return is required. To determine the appropriate tangible asset level to use in this analysis we compared the Subject's asset turnover (excluding intangible assets) with the industry. The Subject's asset turnover was 12.1 compared with an industry average of 6.2 (based on information presented in the RMA analysis). This comparison indicates the Subject has fewer assets than the industry average. Given the preceding discussion, we believe the best estimate of a capitalization rate for very few tangible assets category.

Exhibit 6-7

Development - Rate of Return - Intangible Assets

Equity Capitalization Rate of Return	22.2			
Cap Rate of Return - Tangible Assets	(8.3)			
Premium for Intangibles	13.9			
Description of Assets	Spread	Premium for Intangibles	Earnings Cap Rate	Intangible Capitalization Rate
Very Few Tangible Assets	162.5%	22.5	22.2	44.7
Moderate Level of Tangible Assets	100.0%	13.9	22.2	36.0
High Level of Tangible Assets	62.5%	8.7	22.2	30.8

6.5.5 Indication of Intangible Asset Value

The following exhibit summarizes our calculation of the Subject Company's intangible asset value using a capitalization of excess earnings method.

Exhibit 6-8

Excess Earnings Method		
Forecasted EBIT to Invested Capital		345,767
FMV Tangible Assets	893,410	
Rate of Return for Tangible Assets *(Yield)*	8.3%	
Less: Return on Tangible Assets		(73,992)
Excess Earnings Available to Intangible Assets		271,775
Selected Intangible Asset Rate		44.7%
Value of Intangible Assets		$ 607,998

6.5.6 Summary and Indication of Adjusted Book Value Method

The Subject's indicated fair market equity value based on the adjusted book value and excess earnings methods is illustrated in the following exhibit. This method produced a value on a control interest, "closely held marketable" basis because the tangible and intangible assets were valued at their fair market value.

Exhibit 6-9

Adjusted Book Value Method	
Fair Market Value of Tangible Assets	893,410
Fair Market Value of Intangible Assets	607,998
Indicated "Invested Capital" Value for a 100% Interes	$ 1,501,409
Less: Interest Bearing Debt	(147,348)
Fair Market Value of Equity for 100% Interest	$ 1,354,061

7 Adjustments to the Indication of Values

Before arriving at a final opinion of value, the appraiser must consider adjustments appropriate to this valuation assignment. The most common adjustments to values initially determine the differences between the level of control and/or marketability in the interest being appraised versus the level reflected in the value initially determined by each method employed. Although adjustments may be required for differing levels of lack of control and marketability, each are considered separately.

Therefore, the issues related to level of control must first be considered and once correctly reflected, any adjustments necessary to properly reflect any lack of marketability will be determined. Adjustments may also be required for non-operating assets that were previously excluded from this analysis, but must be considered in determining the final opinion of value.

7.1 Non-operating and Excess Assets

As discussed in Section 5 of this report ("Adjustments to Financial Statements"), we removed $470,000 of excess cash and the Company's airplane (estimated value $12,000) from the balance sheet. In addition, we identified an unrecorded asset (parcel of land) with an appraised value of $2,000. These amounts will be added back in the reconciliation section of this report, to arrive at our final estimate of value.

7.2 Adjustments for Control

The valuation assignment here was to estimate an opinion of value for one-share of voting stock of the Company. The market and asset based methods utilized in this report generated an estimate of value on a control basis therefore an adjustment for control issues are necessary.

Discounts for lack of control (DLOC) exist[13] for two sets of reasons:

- (a) Investors lacking control (minority) ownership interests in an operating business have several disadvantages relative to a controlling shareholder:

  (i). inability to change the suboptimal management of the business.

  (ii). disproportionate distribution of cash flow and other economic benefits to control equity holders.

  (iii). timing of distributions of cash flow and other economic benefits to meet the needs of the controlling equity holders.

  (iv). limited access to information.

  (v). right to liquidate or sell corporation assets.

- (b) There are differences in the market for minority ownership interests in a company and the market for the company as a whole.

Many minority shareholders believe the shares they hold are worth the same as a controlling shareholder. However, a controlling block of stock is generally worth more than a minority owner's fractional interest, mainly because; it is generally easier to sell a controlling block than a non-controlling block. When an investor lacks elements of control, a reduction in value is in order to recognize this difference.

Exhibit 7-1 summarizes the *Mergerstat Review Study*, published by FactSet Mergerstat, LLC, which compiles statistics on publicly announced mergers, acquisitions and divestitures involving operating entities. The study reports that for years 19XX through 20XX, average premiums offered for control when acquiring stock have ranged from 23.1 to 41.1 percent, implying average discounts for lack of control ranging from 18.8 to 29.1 percent, with an implied average discount for lack of control of 24.1 percent.

[13] Source: The Handbook of Business Valuation and Intellectual Property Analysis 2004

Exhibit 7-1

Mergerstat Review			
Buyout Year	Number Transactions	Median Premium Paid %	Implied Median DLOC %
19XX	723	34.6	25.7
20XX	574	41.1	29.1
20XX	439	40.5	28.8
20XX	326	34.4	25.6
20XX	371	31.6	24.0
20XX	322	23.4	19.0
20XX	392	24.1	19.4
20XX	454	23.1	18.8
20XX	491	24.7	19.8
20XX	294	36.5	26.7
20XX	239	39.8	28.5
		Range Low	18.8
		Range High	29.1
		Mean Implied DLOC	24.1

In Exhibit 7-2, this appraiser reviewed selected issues relating to the Company's DLOC. A factor analysis score of "*plus*" increases the marketability discount, and a "*negative*" score decreases the discount. A "*zero*" has a neutral effect. Starting with the 24.1 percent baseline (the average of the last ten years) DLOC from the aforementioned exhibit, the factor analysis conclusion provides an initial indication of a 24 percent DLOC, which is equal to the starting baseline figure.

Exhibit 7-2

Factors Affecting The Degree of Control					
Factors	*Conclusion*	*Score*	*Factors*	*Conclusion*	*Score*
Are distributions equal?	Yes	0	Are there dilution/pre-emptive rights?	No	0
Are voting rights equal?	Yes	0	Is the duration of control limited?	No	+
Does the owner have a board seat?	Yes	-	Can perquisites be controlled?	No	+
Is share ownership concentrated?	No	0	Are government regulations pervasive?	No	0
Is a change in control likely?	No	0	Is management of good quality?	Yes	0
Does the interest have a swing vote?	No	0	Is there management depth?	No	+
Are there restrictions on management?	No	-	Is dependence on key people?	Yes	+
Is there control of accounting?	Yes	0	Is there management life insurance?	No	+
Are insider transactions permitted?	No	-	Is there disability insurance?	No	+
Can by-laws, etc. be amended?	Possibly	0	Is there business protection insurance?	No	-
Can management be changed?	Possibly	+	Are owners/managers deeply involved?	Yes	-
Are there protective laws/regulations?	Yes	-	Are shareholders harmonious?	Yes	-

Estimated Discount Lack of Control

Number of factors analyzed	24.0	Selected DLOC baseline	24.0%
Net Additional factors	-	Adjustments factor	1.000
Total factors supporting DLOC	24.0	Indicated DLOC	24.0%
Adjustment factor	1.000	Rounded DLOC	24.0%

7.2.1 Minority Discount for Lack of Control Conclusion

Based on this analysis, we selected a 24 percent DLOC as being appropriate in this case because we are valuing one-share of voting stock in ABC Communications, which has no control prerogatives and there are only four shareholders, none of whom owns a controlling interest (control typically equates to 51 percent or more) of the outstanding voting common shares. These factors are partially offset by the fact that Arizona has state statutes granting certain minority shareholders rights in certain instances (shareholder oppression statues).

7.3 Adjustments for Marketability

The *discounted future earnings* method resulted in a publicly traded equivalent marketable value because the discount rate was determined by considering general market data from Duff & Phelps. However, in this instance we are valuing a closely held company, which generally requires a longer period of time to sell, therefore we believe a discount for a lack of marketability is required.

The *adjusted book value* method produced a value on a closely held marketable basis because the tangible assets were adjusted to their fair market value, assuming a reasonable time to sell. The *direct market data* method also provided an indicated value on a closely held marketable basis (including time to sell). However, in this valuation, we are valuing a minority interest that cannot force the sale of the assets or the Company. Therefore, we believe a discount for lack of marketability is required for both of these methods.

An additional consideration must be made with respect to the specific categories of assets being held by a given corporation, whether it is of stock in an operating company (and whether it's closely held or a public company), real estate or of cash holdings.

When assessing the appropriate adjustment to apply, it is critical to accurately pair the available market data used, with the corresponding specific assets of the Subject Company. This is important so that adjustments related to operating companies are not misapplied to cash or similarly secure asset holdings, which do not carry similar risk levels or benefits from a controlling involvement, as do intangible assets related with operating companies.

Conversely, safer cash/cash equivalent holding corporation adjustments ought not to be misapplied to operating companies. Rather, the adjustments related to similar classes of assets must be appropriately paired in each instance. In this instance, the Subject interest is a share of common stock in a closely held operating company, as of the valuation date. We will take this factor into consideration when we apply discounts in this instance.

7.4 Lack of Marketability Discount

Marketability adjustments are appropriate when the basis of the indicated values is different from the basis value. The following discussion explains the basis obtained using the selected valuation methods.

- **Discounted Future Earnings Method:** The discount rate was determined by considering general public market data compiled by Duff & Phelps. The resulting value therefore has an attribute of being a freely traded investment. A freely traded investment basis is not appropriate for ABC Communications. The Subject is closely held, has one location, and is a business type that is not fairly common throughout the United States. There may be several interested and able buyers, indicating the Company is somewhat marketable. Also, our assignment is to value one-share of voting stock, adding to this lack of marketability in the marketplace. We believe a discount for lack of marketability is required because of the difference in time required to realize the cash proceeds of the sale of the Company (months) compared to the sale of a freely traded security (7 days or less to receive the cash).

- **Direct Market Data Method:** This method used comparable sold transactions of "closely held" companies to arrive at an indication of value for our Subject Company. These transactions were for a 100 percent interest; therefore an adjustment is required to account for the difference in the degree of ownership interest inherent in this method. Hence, a DLOM is warranted for estimating the value of one-share of voting stock in the Company.

- **Adjusted Book Value Method:** The method produced a value on a "closely held marketable" basis because the tangibles were re-valued at their fair market values. However, in this valuation, we are valuing a minority interest that cannot force the sale of assets. Therefore, an adjustment for difference in degree of marketability is required.

7.4.1 Conceptual Basis

A major difference between the shareholder's interest and those of its publicly traded counterparts is its lack of both transferability and liquidity, which results in a need for a discount for lack of marketability (DLOM).

- Transferability[14] denotes the right to sell an asset in a market within a reasonable time frame at relatively low transactional costs, along with minimal effect on its value. Transferability is limited by ownership agreement, lack of disclosure, and the time and cost to rectify it.

- Liquidity relates to how quickly and certainly a security ownership interest can be converted into cash at the owner's discretion. Investors value liquidity and will pay a premium for liquidity or demand a discount for the lack of liquidity.

At the present time, no direct evidence is available regarding the magnitude of DLOM for closely held operating companies, because such transactions are not disclosed and there are no fully liquid and transferable comparison points. A DLOM can only be estimated with public equity market data and models. The primary sources of public equity market data are empirical and theoretical models. Empirical models are based on actual transactions that have occurred in the marketplace, while theoretical models are based on economic formulas.

[14] Although public equity transaction costs have declined as a result of the elimination of fixed commissions, telecommunications, financial technology, and large trading volumes, none of these cost economies affect closely held business owners.

7.4.2 Empirical Models

There are four empirical models: restricted stock, pre-IPO, flotation costs, and liquidity. These models reflect a stock's transferability and/or liquidity (see following summary table).

Restricted Stock Studies

Restricted stocks are identical in all respects to the freely traded stocks of public companies except they are restricted from trading on the open market for a certain time period. Marketability is the only difference between a restricted stock and its freely traded counterpart. These studies have attempted to find differences in the price at which restricted stock transactions take place compared with open market transactions in the same stock on the same date.

There are three major problems associated with the restricted stock studies. First, shares analyzed in the restricted stock studies differ from shares in closely held companies in a number of important ways including: a known limited holding period, financial reporting transparency, and the liquidity of the public market. Second, the discounts identified in the studies have a very wide range. Third, many of these studies do not provide sufficient information on each transaction included in the study.

Pre-IPO Studies

Pre-IPO studies have analyzed price transactions in a company's stock relative to its public offering price and its market price following its initial public offering. Emory Business Valuation, Willamette Management Associates, and Valuation Advisors are the primary organizations responsible for the development of the pre-IPO data. The major issues concerning the pre-IPO studies are: many of the transactions appear to be with insiders and the private transaction price was not adjusted for the time value of money.

Flotation Cost Model

The flotation cost model estimates a DLOM by measuring the cost of creating marketability. Flotation costs represent the cost of going public. Flotation costs include both fixed and variable costs. The major fixed costs are audit fees, legal fees, and printing costs. The major variable cost is underwriter's fees, expressed as a portion of gross proceeds, these costs generally increase as risks associated with the issuer increase, or the size of the offering decreases. The major issue concerning flotation costs is the characteristics of the companies included in the data. They are significantly larger and have a higher expectancy of being a successful public company than the majority of closely held companies.

Liquidity Studies

Liquidity studies show there are significant differences among publicly traded firms of different sizes. Larger firms are more liquid than smaller firms, have smaller spreads and are less costly to trade. Among smaller stocks, 24 percent do not trade at all on a given day. The observed bid-ask spread is around 14 percent The measured cost of trading small lots for small firms is around 10 percent. The major issues concerning the liquidity studies is even the smallest publicly traded companies are significantly larger than most closely held companies.

Selecting an empirical model, as discussed previously, all of these models are sensitive to uncertain assumptions. Therefore, we considered all generally accepted DLOM models.

The following table summarizes the empirical DLOM studies. These studies suggest an average DLOM for all of the studies is 24.6 percent. Excluding the flotation studies, which are commonly applied only to control interests since minority stockholders lack the power to bring common stock to the market, the adjusted average discount is 29.4 percent.

Exhibit 7-3

Lack of Marketability Discount Studies

Study	Author	Type	Low	Mean	High	Transfer	Liquidity
Flotation	Abbott	Private Going Public	0.4	6.1	11.4	Yes	No
Flotation	Bajaj	Private Going Public		7.2		Yes	No
Flotation	Pratt	Private Going Public	15.0	17.5	20.0	Yes	No
			Average	10.3			
Restricted Stock	Hertzel	Public		13.5		Yes	No
Restricted Stock	Wruck	Public	10.4	14.0	17.6	Yes	No
Restricted Stock	Johnson	Public		20.0		Yes	No
Restricted Stock	SEC	Public		23.0		Yes	No
Restricted Stock	Willamette	Public		31.0		Yes	No
Restricted Stock	Gelman	Public		33.0		Yes	No
Restricted Stock	Trout	Public		34.0		Yes	No
Restricted Stock	Siber	Public		34.0		Yes	No
Restricted Stock	Maher	Public		35.0		Yes	No
			Average	26.4		Yes	No
Private Placement	Bajaj	Public Registered		14.0		No	Yes
Partnership Profiles	Jeffries	Public	21.0	34.5	48.0	No	Yes
Bid-Ask Spread	Bremmam	Public		35.5		No	Yes
			Average	28.0			
Acquisition	Koeplin	Private Going Public		20.4		Yes	Yes
Private Placement	Bajaj	Public		22.2		Yes	Yes
Private Placement	Bajaj	Private Unregistered		28.1		Yes	Yes
Pre-IPO	Willamette	Private Going Public	32.0	47.5	63.0	Yes	Yes
Pre-IPO	Emory	Private Going Public	42.0	51.0	60.0	Yes	Yes
			Average	33.8			

In Exhibit 7-4, this appraiser reviewed selected issues relating to the Company's DLOM. Using the same factor analysis score of a *"plus"* increases the marketability discount, a *"negative"* score decreases the discount, and a *"zero"* is neutral, we can determine a discount applicable to our Subject. Starting with the 29.4 percent baseline DLOM from the aforementioned exhibit, the factor analysis conclusion provides an initial indication of a 35.3 percent DLOM, which is higher than the starting baseline amount.

Exhibit 7-4

Factors Affecting The Degree of Marketability

Factors	*Conclusion*	*Score*	*Factors*	*Conclusion*	*Score*
Are there cash distributions?	No	+	Is there a right of first refusal?	No	-
Are distributions certain?	Somewhat	0	Is there an active secondary market?	No	+
Are distributions frequent?	No	+	Is the redemption term long?	Yes	+
Is business model diversified?	No	-	Is there a clear exit strategy?	No	+
Are there embedded capital gains tax issues?	Yes	+	Are potential buyers present?	Yes	-
Are industry growth prospects good?	Somewhat	0	Is there a buy-sell agreement?	No	0
Are business growth prospects good?	Somewhat	0	Is there a blockage risk?	No	0
Are there withdrawal rights?	No	+	Is there bankruptcy risk?	No	-
Any past arm's-length transactions?	No	0	Is financial information reliable?	No	+
Are there transfer restrictions?	No	-	Is there a prospect of going public?	No	+

Estimated Discount Lack of Marketability

Number of factors analyzed	20.0	Selected DLOM baseline from Studies	29.4%
Net Additional factors	4.0	Adjustments factor	1.200
Total factors supporting DLOM	24.0	Indicated DLOM	35.3%
Adjustment factor	1.200	Rounded DLOM	35.0%

7.4.3 Marketability Discount Conclusion

Given the preceding discussion, we believe the best estimate of a discount for lack of marketability of a minority interest in ABC Communications, Inc. is 35 percent. A rate slightly higher than the baseline is considered appropriate because there is no immediate public offering or sale of the business and the expected lengthy holding period.

8 Reconciliation of the Valuation Estimates

At this point in the appraisal process, the appraiser must consider the relative merits of each method employed and determine the degree of influence or weight each method will have in the final opinion of value. The weighting of valuation methods is not an exact science and is presented in mathematical terms only to assist the reader in interpreting the appraiser's thinking as to the relative influence given to each method. The factors that influence the appropriate degree of emphasis for different methods may change over time and thus the methods used and the weightings applied to each may be different in valuing the same business at a different time and/or under different circumstances. Our view of the merits of each of the valuation methods is discussed below.

- **Discounted future earnings**. Valuation professionals generally accord this method primary consideration when valuing operating companies with positive earnings. In addition, the income approach is advocated in Revenue Ruling 59-60 for the valuation of operating companies. In this case, we forecasted a pre-tax earnings stream and determined an appropriate discount rate by utilizing Duff & Phelps data. We have some question concerning the reliability of the forecasted financial data. However, we have little reason to question the discount rate, which was based on market evidence. The value indicated using this method arrived at a minority, freely traded basis. Therefore, an adjustment is required to reflect the difference in marketability, as discussed earlier in this report, we will apply a 35 % discount for lack of marketability to convert the "as if freely traded "marketable value to a "closely held" marketable value. *We will accord this method the greatest amount of weight in our conclusion of value.*

Direct Market Data method. Valuation professionals generally accord this method significant consideration if a group of closely held companies in the same or similar line of business as the Subject can be identified. In addition, the market method is advocated in Revenue Ruling 59-60 for the valuation of operating companies. In this case, the selected closely held company transactions were of businesses similar to the Subject Company from an investment standpoint, not necessarily from a product standpoint. We would have preferred more information concerning the transactions and companies. In addition, the value multiples varied significantly between companies, which made it difficult to determine an appropriate multiple. The value arrived at using this method is on a "control, closely held" basis. Hence, a discount for lack of control, as discussed earlier in this report, is warranted. The Direct Market Data method reflects a small level of lack of marketability discount (cannot receive the funds within three business days), as multiples are derived from actual sold transactions of closely held companies. However, these transactions reflect sales of 100% interests and our assignment is to value one-share of voting stock, which will take much longer to sell than a 100% interest. We have elected to take a discount of 25 percent for the difference in the lack of marketability of our Subject's one-share versus the market data for 100% interests. *This method will receive a similar weight as the Adjusted Book Value method in our conclusion of value.*

Adjusted Book Value method. Valuation professionals generally accord the asset approach primary consideration when valuing asset-intense businesses, holding companies, and companies not generating positive cash flow. This method is generally accorded less weight than income or market based methods when used for companies generating positive cash flow. This method used the least reliable data for three reasons: (i) it required an estimate of the value of the tangible equity based on reasonable, but imprecise estimates of the market value of the tangible assets, (ii) it required an estimate of the rate of return on net tangible assets, based on imprecise estimates of market rates of return, and (iii) it required an estimate of the direct capitalization rate used in the valuation of the intangible assets, which was less precise than the development of the rate used in the discounted future earnings method. However, this method cannot be disregarded as actual Company data was used to arrive at a conclusion of value. The value arrived at using this method, as discussed earlier in the Direct Market Data method, is on a "control, closely held" basis, and for the same reasons will require a discount for lack of marketability. *This method will receive the same amount of confidence weight as the Direct Market Data method to arrive at our final opinion of value.*

Based on our review of the merits of each method, we assigned 60 percent of the weight to the Discounted Future Earnings method, 20 percent to the Direct Market Data method, and 20 percent to the Adjusted Book Value method.

Note: There is no empirical basis for assigning mathematical weights. The weights are presented only to help clarify the thought process of the appraiser

Exhibit 8-1 illustrates our reconciliation of values for ABC Communications, Inc. An adjustment is made to add the excess cash and airplane, which were removed from the balance sheet during the normalizing process in Section 5 of this report. We also added the value of the vacant land in Valle, Arizona appraised at $2,000, which was not on the Subject's balance sheet.

Exhibit 8-1

Reconciliation of Indicated Values

Valuation Method	Value and Basis Indicated by Method	Adjustments in Degree of Control	Adjustments in Degree of Marketability	Adjusted Value and Basis	Weighted Confidence Level	Weighted Component Value
Discounted Future Earnings Method	1,589,609 Minority, Freely Traded	0.00	-0.35	1,033,246 Minority, Closely-Held	0.60	$ 619,947
Direct Market Data Method	1,556,552 Control, Closely-Held	-0.24	-0.25	887,235 Minority, Closely-Held	0.20	$ 177,447
Adjusted Book Value Method	1,354,061 Control, Closely-Held	-0.24	-0.25	771,815 Minority, Closely-Held	0.20	$ 154,363

Initial Indication of Value	$	951,757
Add: Excess Cash		470,000
Add: Airplane		12,000
Add: Land		2,000
Indicated Minority Interest Equity Value for 100%, on a Closely Held Basis *(Rounded)*	$	1,436,000
Divided by Outstanding Shares		1,000
Fair Market Value of Equity for ONE Minority Share on a Closely-Held Basis	$	1,436

In the appraiser's opinion, the value of ONE equity voting share, in a corporation known as ABC Communications, Inc. dba ABC Communications, as of September 26, 201XX is best expressed as:

$1, 436.00
(One Thousand Four Hundred Thirty Six Dollars)

This conclusion is based on four key assumptions: (i) it values the Subject company's stock, an asset sale would be priced at a value reflecting the specific assets and liabilities involved; (ii) it values the stock at the most probable price any willing buyer would pay, not the maximum price a specific buyer might justify or one that a seller might ask; (iii) it values a minority interest; and (iv) the value has been reduced to reflect the absence of no ready market for the Subject Company's stock.

Appendices A - Professional Qualifications