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## **S Corp. vs. C Corp. Valuation**

(Revised 12-20-02)

### **Minimal impact even after not-tax-affecting S Corp. income**

#### **Background:**

Valuation of S Corp. vs. C Corp. has received focus as a result of three recent court rulings in *Gross*<sup>1</sup>, *Adams*<sup>2</sup>, and *Heck*<sup>3</sup>. According to these court rulings S Corp. income should not be tax-affected for valuation purposes. This is in contrast to the common practice by the valuation community of tax-affecting S Corp. income.

If one were to use traditional income approach for valuation, not tax-affecting S Corp. income would cause S Corp. to be valued higher than an otherwise identical C Corp. The value difference could be significant. As an example, an S Corp. could be valued 1.66 times more than an identical C Corp. if both had the same operating income, no debt and the C Corp. tax rate was 40%.

However, such valuation difference between an S Corp. and an otherwise identical C Corp. is not found in the market<sup>4</sup>. Also, the valuation practitioners value both corporate structures essentially the same. They arrive at equal value for an S Corp. and a C Corp. by tax-affecting S Corp. income, and using traditional income approaches for valuation (tax-affecting means reducing S Corp. income by the tax liability incurred by the S shareholder). If they were to implement the above court rulings of no tax-affecting, and continue using traditional income approach for valuation they will wind up valuing S Corp. significantly higher than an otherwise identical C Corp.

So, the question arises, is the court decision correct? If the answer is yes, then may be the market is wrong in assigning equal values to both the corporate structures. However, market being wrong is unlikely. This leads one to the easy route of challenging the court decision. However, there is another explanation ... the valuation process is flawed.

Below is an analysis by the author, Mike Adhikari (MBA, MSME, MSEE, CBI, CM&A), on the above subject. Adhikari has 15+ years of experience as an M&A intermediary involving

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<sup>1</sup> *Gross v. Commissioner*, T.C. Memo. 199-254, affd. 272 F.3d 333 (6<sup>th</sup> Cir. 2001)

<sup>2</sup> *Adams v. Commissioner*, T.C. Memo. 2002-80, Filed March 28, 2002.

<sup>3</sup> *Heck v. Commissioner*, T.C. Memo. 2002-34, Filed February 5, 2002.

<sup>4</sup> Even though the author has not seen any market data on the subject, one would expect such sharp differences not to go unnoticed.

transaction valuation. The analysis is backed by a new business valuation method developed by him<sup>5</sup>.

### Summary:

The court ruling that the S Corp. income should not be tax-affected is a correct decision. Also, the market is correct in valuing the S Corp. and C Corp. equal. However, the traditional income based valuation approach is inadequate.

A vast majority of the transactions in the real world are financially leveraged transactions<sup>6</sup>. Market databases reflect these leveraged transactions. Financial leverage reduces taxable income, and hence reduces the negative impact of C Corp. double taxation. In addition shareholders are generally not permitted to take distributions under financial leverage. Thus, the “cash distributed” to the shareholder under financial leverage is little or none, which tends to equalize S Corp. and C Corp. valuation.

When S Corp. and C Corp. are valued based on “cash distributed”, as is done here, there is minimal value difference between the two if there is financial leverage. This is true even when S income is not tax-affected. Traditional valuation methods are inadequate because they are based on “income” earned, or on generated “free cash flow”, rather than on “cash distributed”. If there were no financial leverage (i.e. 100% equity infusion), an S Corp. would be valued significantly higher than an equivalent C Corp.

### Analysis:

Following are some comments and clarifications on topics related to S Corp. vs. C Corp. valuation.

- 1) Value of a firm is determined based on cash flow to the investor and his expected pre-tax ROI<sup>7</sup> using DCF (Discounted Cash Flow) method<sup>8</sup>. The cash flow to the investor is the distribution from the after-tax income of the corporation<sup>9</sup>. Investor's pre-tax ROI should be based on “distribution received”; it should not be based on income or free cash flow of the corporation. The word “pre-tax” means that the ROI is measured on the gross cash flow received by the investor before the investor pays shareholder level taxes on the distribution. It also implies that the investor has no other liability arising from his interest in the entity other than the shareholder level taxes on the “distribution received”.
- 2) Some experts have argued, “How can two identical businesses with same operating income have different values, just because one is an S Corp. and the other a C Corp.?”

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<sup>5</sup> Software incorporating the new method is commercially available at [www.BusinessValueXpress.com](http://www.BusinessValueXpress.com).

<sup>6</sup> Based on author's experience. Author has not seen any statistics on the subject.

<sup>7</sup> Pre-tax ROI is used in the industry to eliminate the differences in actual tax rate of various shareholder types. Pre-tax-ROI is different than “discount rate”. Discount rate blends the return expectations of the debt holder and the pre-tax ROI expectations of the equity holder. Pre-tax ROI is cleaner because it only looks at return to the shareholder.

<sup>8</sup> There are many methods of valuation. DCF is the backbone of all methods. DCF can give accurate results when applied to post-acquisition TCF (True Cash Flow) to the buyer.

<sup>9</sup> Some people call the ROI calculated using after-tax proceed as “after-tax” ROI. That would be a misstatement. It is based on corporation's after tax distribution, but it is a pre-tax ROI to the investor, because the investor still needs to pay taxes on the distribution.

This is entirely possible. As discussed earlier, investor's value assessment is based on his expected pre-tax ROI. Higher the cash flow to the investor, higher the value, if pre-tax ROI expectation is the same. Such would be the case for an S Corp. over a C Corp., if the purchase is with 100% equity.

- 3) In situations where an ownership change does not involve a third party, a business should be valued based on what an independent buyer would pay. Value to the independent buyer depends on the expected future cash flow to him ... not on prior cash flow, or prior earnings, or prior dividend policy<sup>10</sup>. The valuation would be high if one assumes financial leverage, and the value would be low if one assumes no financial leverage i.e. 100% equity infusion.
- 4) Traditional income based valuation approaches use "income" earned, or generated "free cash flow" as a proxy for investor's cash flow. As discussed earlier, this substitution is wrong ... value should be based on "distribution received", not on income or free cash flow. Unfortunately, we have used these "wrong" measures for so long that they are accepted as the "right" approach. The debate on, to tax-affect or not to tax-affect S Corp. income, arises primarily due to the use of these "wrong" measures as a proxy to investor's cash flow.
- 5) If one were to value a business based on actual cash flow to the investor, valuation of an S Corp. based not tax-affecting, will be closer to that of a C Corp. under financial leverage. Financial leverage is commonly used in the market place to lower buyer's cost of capital, which helps the buyer afford a higher price. However, the effect of the leverage is to lower the available cash for distribution. Also, with financial leverage, corporation's taxable income is reduced, which diffuses the impact of the tax differences between the C and the S Corp. Financial leverage also consumes cash for debt service, thus further reducing the cash available for distribution. And, leverage invites dividend restrictions from lenders. All of these factors reduce available cash for distribution and are applicable to both the S Corp. and the C Corp. As a result the cash flow to the investor is basically the same regardless of the corporate structure.

### Impact of financial leverage on S Corp. vs. C Corp. valuation

Following is a valuation analysis of XYZ Inc. XYZ is valued 4 different ways. The two variables making up 4 combinations are corporate structure and financial leverage.

In Scenario-A, XYZ is being acquired without financial leverage. In Scenario-B, XYZ is being acquired with financial leverage. In both the scenarios XYZ is valued as if it were an S Corp. and a C Corp. The analysis is based purchasing 100% of the stock of XYZ. It is also assumed that the buyer will be able to sell XYZ at exit for the same purchase price multiple that he paid at purchase.

In the example, XYZ has sales of 5000 and an EBITDA<sup>11</sup> of 500. It has no growth, and no debt. 100% of the earnings are distributed as dividend if they are not required in the operation. In the

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<sup>10</sup> However, one must realize that past performance plays a significant role in developing a believable future forecast.

<sup>11</sup> The author does not necessarily endorse the use of EBITDA. It is used in the article for convenience.

S Corp. analysis company distributes cash to cover shareholder taxes, and any excess distribution is grossed up back to the pre-tax level for calculating shareholder's pre-tax ROI. Table – 2 provides more details of XYZ Inc.

Scenario-A has no financial leverage, does not require profits to be reinvested and has no tax benefits resulting from such things as depreciation. Fixed assets are eliminated in Scenario-A to avoid the impact of depreciation on valuation. These assumptions permit distribution of 100% of the earnings. Scenario-A is generally not observed in real life, but it is used here to show the set of assumptions required for an S Corp. to be valued 1.66 times more than an otherwise identical C Corp.

Scenario-B is a more realistic scenario. Assets are leveraged to reduce overall cost of capital, tax benefits of depreciation are captured, and profits are reinvested for such things as capital expenditures. Scenario-B also assumes that acquisition financing is available as long as the cash flow can support it.

The valuation multiples in Table – 1 are derived by applying DCF method to buyer's cash flow, and using 25% pre-tax ROI. An important distinction is that the DCF is applied to Buyer's cash flow, not to XYZ's cash flow. Buyer's cash flow is calculated after servicing debt, after funding working capital<sup>12</sup>, after funding capital expenditures, and after paying taxes. Each value is derived to simultaneously satisfy the objectives of a willing buyer and a willing seller<sup>13</sup>. So the value is the maximum that the seller can get and the one the buyer can afford, given the parameters of Table – 2. Valuation details (income statement, balance sheet, cash flow and ROI calculations) are provided in Table – 3, 4, 5, and 6.

Table –1  
Valuation Multiples to achieve 25% pre-tax ROI

XYZ Inc.	<u>Scenario-A</u> No Financial Leverage	<u>Scenario-B</u> With Financial Leverage
C Corp.	2.4	4.2
S Corp.	4.0	4.5

Scenario-A, No Financial Leverage: As shown in Table –1, under no financial leverage, buyer can afford to pay no more than a 4x EBITDA multiple for XYZ if it is an S Corp to achieve a 25% pre-tax ROI (S Corp. income is not-tax affected). In this scenario there is no financial leverage, and no growth, and hence the full purchase is funded through equity. He invests 2000 (4 times 500) and gets all of the EBITDA of 500 each year for 5 years as dividend. At exit he gets 2000, the same amount as the purchase price.

However, if XYZ is a C Corp., under no financial leverage, buyer can afford to pay no more than a 2.4x EBITDA multiple for XYZ to achieve a 25% pre-tax ROI. He invests 1200 (2.4 times 500)

<sup>12</sup> Working capital requirement in the example is zero, because there is no growth.

<sup>13</sup> The value is determined using Business ValueXpress™ (BVX™), a software developed by the author. It is available at [www.BusinessValueXpress.com](http://www.BusinessValueXpress.com). BVX™ determines an equilibrium value that satisfies a willing buyer's requirement of achieving his expected pre-tax ROI and being able meet his cash flow needs; and a willing seller's requirement of getting a maximum price. BVX™ does not use any formula or WACC.

and gets only 300 each year for 5 years as dividend. (C Corp. pays 200 in taxes, so the amount available for distribution is not 500, but 300). At exit he gets 1200, the same amount as the purchase price.

If the buyer were to pay for a C Corp. XYZ, the same price he can afford to pay for an S Corp. XYZ, i.e. a multiple of 4, his pre-tax ROI would drop to 15%. (In this case buyer's cash flow would be an investment of 2000, distribution of 300 for 5 years and exit at 2000).

The above analysis clearly shows that, under the scenario of no financial leverage, the S Corp is valued higher than the C Corp. where the criterion for valuation is that the investor gets the same pre-tax ROI. The S Corp. is valued at a 4 multiple and the C Corp. is valued at a 2.4 multiple of EBITDA. The S Corp. value is 1.66 times more than an otherwise identical C Corp.

The exact relationship of an S Corp. vs. a C Corp. valuation, in case of no financial leverage, no growth, no reinvestment and if all earnings are distributed to the shareholder, is

$$V_s = V_c / (1-t_c)$$

$V_s$  is the value of an S Corp.  
 $V_c$  is the value of a C Corp.  
 $t_c$  is C Corp. tax rate

It is also worth noting that the S Corp. multiple is equal to  $1/r$ , where  $r$  is buyer's expected pre-tax ROI. And the value of a C Corp. is  $(1-t_c)/r$ . One should not apply a multiple of  $1/r$  to the C Corp.

$$\begin{aligned} \text{EBITDA Multiple for an S Corp.} &= 1 / r && r \text{ is buyer's expected pre-tax ROI} \\ \text{EBITDA Multiple for an S Corp.} &= (1- t_c) / r \end{aligned}$$

Scenario-B, With Financial Leverage: As shown in Table –1, with financial leverage, buyer can afford to pay no more than 4.5x EBITDA multiple if XYZ is an S Corp. to achieve a pre-tax ROI of 25% (S Corp. income is not tax-affected). However, if XYZ is a C Corp. he can afford to pay no more than 4.2x EBITDA multiple to achieve a pre-tax ROI of 25%. Buyer's cash flow is calculated after considering the interest cost of the debt, the debt service, and the capital expenditure. (Details of the actual financials are shown in Table – 3,4,5,6. This valuation is derived using the valuation software developed by the author<sup>14</sup>).

Under financial leverage, and without tax-affecting S Corp. income, the price differential between an S Corp. and a C Corp. is a multiple of 4.5 vs. 4.2 i.e. S Corp. valuation is 1.07 times more than an otherwise identical C Corp. The S vs. C valuation spread is only 7% under financial leverage and 66% without financial leverage. This spread would further narrow if lender restriction of no dividend distribution were implemented. (Note: In the analysis here S Corp. income is not tax-affected. In addition, the analysis makes adjustment at exit for S retained earnings, which are tax free to the shareholder.)

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<sup>14</sup> The value is determined using Business ValueXpress™ (BVX™), a software developed by the author. It is available at [www.BusinessValueXpress.com](http://www.BusinessValueXpress.com). BVX™ determines an equilibrium value that satisfies a willing buyer's requirement of achieving his expected pre-tax ROI and being able meet his cash flow needs; and a willing seller's requirement of getting a maximum price. BVX™ does not use any formula or WACC.

The following observations are worth noting:

- 1) Valuation with financial leverage is higher than w/o financial leverage. This is true for both the S and the C Corp. This is a result of reduction of overall cost of capital with financial leverage. For S Corp. financial leverage raises the valuation from 4.0 to 4.5. For C Corp. financial leverage raises the valuation from 2.4 to 4.2.
- 2) Financial leverage impacts C Corp. valuation more than S Corp. valuation. This is a result of tax savings from interest cost deduction. These tax savings are more in a C Corp. than in an S Corp.
- 3) Financial leverage significantly reduces equity infusion while increasing the valuation. In the example here, the equity infusion w/o leverage is 2000 (for S Corp.) and 1200 (for C Corp.). The equity infusion under financial leverage drops to 642 (for S Corp.) and 513 (for C Corp.).

Final comments: Court decision of not tax-affecting S Corp. income is a correct one. Market that values both the S Corp. and the C Corp. more or less equal is also correct. The reason for differential valuation of an S Corp. and an otherwise identical C Corp. is current valuation methods. The formulas and methods used today to transform income and/or cash flow to value are not applicable under financial leverage, which happens to exist in most all transactions. When one calculates the actual cash flow to the buyer under financial leverage, there is no material difference between an S Corp. and a C Corp. valuation, even when S Corp. income is not tax-affected.

Table – 2

XYZ Corp

	<u>Scenario A</u>	<u>Scenario B</u>
Sales	5000	same
EBITDA	500	same
A/R	500	same
Inventory	400	same
A/P	300	same
Existing Debt	0	same
Growth	0	same
Growth Working Capital	0	same
Dividend Distribution	100% of available cash	same
Buyer Synergy	None	same
C Corp Tax Fed+State	40%	same
S Corp. Tax State	0%	same
S Shareholder Tax	40%	same
Deal Structure	Stock	same
Payment	All cash	same
Buyer's Pre-tax ROI	25%	same
Exit Multiple	= Purchase Multiple	same
S Distribution	Grossed up in excess of taxes	same
Fixed Assets Book Value	0	250
Fixed Assets FMV	0	500
Depreciation	N/A	5 years
Capital Expenditure	0	10% of EBITDA
Financing	None	Yes (see below)

Financing

A/R revolver	80% of A/R at 10% interest
Inventory revolver	40% of inventory at 10% interest
Term Loan	80% of FMV of fixed assets, 5 years at 10% interest
Capital Exp. Loan	75% of cost, 5 year at 10% interest
Cash Flow Loan	Available as needed, 5 years at 10% interest (In small deals seller steps in if cash flow lending is not available)

<u>Valuation Summary</u>										
Price Multiple		4.47 EBITDA		Business Value		2234				
		4.96 EBIT								
<u>Income Statement</u>		<u>Year0</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>			
Sales		5000	5000	5000	5000	5000	5000	5000		
EBITDA		500	500	500	500	500	500	500		
		10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%		
<u>Other Expenses/(Income)</u>										
Interest Exp-Revolver			56	56	56	56	56	56		
Interest Exp-Term Loan			40	32	24	16	16	8		
Interest Exp-Cap Ex Loan			4	7	9	11	11	11		
Interest Exp-Gap(Seller): Note			63	51	38	25	25	13		
Depreciation			60	70	80	90	90	100		
Total Other Expenses			223	215	207	198	198	188		
Taxable Income			277	285	293	302	302	312		
Corp. Taxes: State			0	0	0	0	0	0		
Corp. Taxes: Federal			0	0	0	0	0	0		
Net Income			277	285	293	302	302	312		
<u>Balance Sheet</u>		<u>Purch.</u>	<u>Opening</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>		
<u>Assets</u>										
Cash		0	0	0	0	0	0	0		
A/R		500	500	500	500	500	500	500		
Inventory		400	400	400	400	400	400	400		
Fixed Assets-Old		250	250	250	250	250	250	250		
A/D-Old			0	-50	-100	-150	-200	-250		
New Fxd Assets			0	50	100	150	200	250		
A/D-New Fxd Assets			0	-10	-30	-60	-100	-150		
Goodwill		0	1384	1384	1384	1384	1384	1384		
Total Assets		1150	2534	2524	2504	2474	2434	2384		
<u>Liabilites &amp; Equity</u>										
A/P & Accrued		300	300	300	300	300	300	300		
Revolver			560	560	560	560	560	560		
Term Loan			400	320	240	160	80	0		
Gap(Seller): Note			631	505	379	253	126	0		
Cap Ex Loan			0	30	53	68	75	75		
Non-Operating Liab.			1591	1415	1231	1040	841	635		
Retained Earnings		0	0	277	562	855	1157	1469		
Distribution for Taxes			0	-111	-225	-342	-463	-588		
Dividends			0	0	-7	-22	-44	-75		
Common Stock		850	642	642	642	642	642	642		
Equity		850	642	809	972	1134	1292	1449		
Total Liab & Equity		1150	2534	2524	2504	2474	2434	2384		
<u>Cash Flow Projections</u>				<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>		
Net Income				277	285	293	302	312		
Depreciation				60	70	80	90	100		
Term Loan Payment				-80	-80	-80	-80	-80		
Gap(Seller): Note Payment				-126	-126	-126	-126	-126		
Capital Expenditure				-50	-50	-50	-50	-50		
Capital Exp Borrowing				38	38	38	38	38		
Capital Exp Payments				-8	-15	-23	-30	-38		
Distribution for S Shareholder Taxes				-111	-114	-117	-121	-125		
Operating Cash Flow-Business				0	7	15	23	31		
<u>Buyer's Pre-Tax ROI</u>		<u>Year0</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>			
Original Equity Investment		-642								
Selling Price @ Exit Multiple								2234		
Less Non-Operating Liabilities			0	0	0	0	0	-635		
Pre-Tax Proceeds from Sale			0	0	0	0	0	1599		
Tax Distribution from Corp. to S-Shrhldr			111	114	117	121	125	125		
Dividend Distribution			0	7	15	23	31	31		
S Dividend Gross Up to Pre-tax			0	5	10	15	21	21		
S Undistribtd Erngs Gross Up to Pre-tax								202		
Taxes from S-Shrhldr to IRS		0	-111	-114	-117	-121	-125	-125		
Pre-Tax Cash Flow		-642	0	12	24	38	1852	1852		
Buyer's Pre-Tax ROI =			25.0%							

**Table -4**  
**C Corp**  
**W/ Leverage**

<u>Valuation Summary</u>		4.21 EBITDA		Business Value		2104		
Price Multiple		4.68 EBIT						
Income Statement		<u>Year0</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>	
Sales		5000	5000	5000	5000	5000	5000	
EBITDA		500	500	500	500	500	500	
		10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	
<u>Other Expenses/(Income)</u>								
Interest Exp-Revolver			56	56	56	56	56	
Interest Exp-Term Loan			40	32	24	16	8	
Interest Exp-Cap Ex Loan			4	7	9	11	11	
Interest Exp-Gap(Seller): Note			63	50	38	25	13	
Depreciation			<u>60</u>	<u>70</u>	<u>80</u>	<u>90</u>	<u>100</u>	
Total Other Expenses			223	215	207	198	188	
Taxable Income			277	285	293	302	312	
Corp. Taxes: State			0	0	0	0	0	
Corp. Taxes: Federal			111	114	117	121	125	
Net Income			166	171	176	181	187	
Balance sheet		<u>Purch.</u>	<u>Opening</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>
<u>Assets</u>								
Cash		0	0	0	0	0	0	0
A/R		500	500	500	500	500	500	500
Inventory		400	400	400	400	400	400	400
Fixed Assets-Old		250	250	250	250	250	250	250
A/D-Old			0	-50	-100	-150	-200	-250
New Fxd Assets			0	50	100	150	200	250
A/D-New Fxd Assets			0	-10	-30	-60	-100	-150
Goodwill		<u>0</u>	<u>1254</u>	<u>1254</u>	<u>1254</u>	<u>1254</u>	<u>1254</u>	<u>1254</u>
Total Assets		1150	2404	2394	2374	2344	2304	2254
<u>Liabilities &amp; Equity</u>								
A/P & Accrued		300	300	300	300	300	300	300
Revolver			560	560	560	560	560	560
Term Loan			400	320	240	160	80	0
Gap(Seller): Note			631	505	379	252	126	0
Cap Ex Loan			<u>0</u>	<u>30</u>	<u>53</u>	<u>68</u>	<u>75</u>	<u>75</u>
Non-Operating Liab.			1591	1415	1231	1040	841	635
Retained Earnings		0	0	166	337	513	694	882
Dividends			0	0	-7	-22	-45	-76
Common Stock		<u>850</u>	<u>513</u>	<u>513</u>	<u>513</u>	<u>513</u>	<u>513</u>	<u>513</u>
Equity		850	513	679	843	1004	1163	1319
Total Liab & Equity		1150	2404	2394	2374	2344	2304	2254
Cash Flow				<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>
Net Income				166	171	176	181	187
Depreciation				60	70	80	90	100
Term Loan Payment				-80	-80	-80	-80	-80
Gap(Seller): Note Payment				-126	-126	-126	-126	-126
Capital Expenditure				-50	-50	-50	-50	-50
Capital Exp Borrowing				38	38	38	38	38
Capital Exp Payments				<u>-8</u>	<u>-15</u>	<u>-23</u>	<u>-30</u>	<u>-38</u>
Operating Cash Flow-Business				0	7	15	23	31
Buyer's Pre-tax ROI		<u>Year0</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>	
Original Equity Investment		-513						
Selling Price @ Exit Multiple								2104
Less Non-Operating Liabilities				0	0	0	0	-635
Pre-Tax Proceeds from Sale				0	0	0	0	1469
Dividend Distribution				0	7	15	23	31
Pre-Tax Cash Flow		-513		0	7	15	23	1500
Buyer's Pre-Tax ROI =				25.0%				

**Table - 5**  
**S Corp.**  
**No Leverage**

		<u>Year0</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>
Income Statement							
	Sales	5000	5000	5000	5000	5000	5000
	EBITDA	500	500	500	500	500	500
		10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
	<u>Other Expenses/(Income)</u>						
	Expenses	0	0	0	0	0	0
	Taxable Income	500	500	500	500	500	500
	Corp. Taxes: State	0	0	0	0	0	0
	Corp. Taxes: Federal	0	0	0	0	0	0
	Net Income	500	500	500	500	500	500
Balance Sheet							
	<u>Purch.</u>	<u>Opening</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>
<u>Assets</u>							
	Cash	0	0	0	0	0	0
	A/R	500	500	500	500	500	500
	Inventory	400	400	400	400	400	400
	Goodwill	0	1401	1401	1401	1401	1401
	Total Assets	900	2301	2301	2301	2301	2301
<u>Liabilities &amp; Equity</u>							
	A/P & Accrued	300	300	300	300	300	300
	Non-Operating Liab.		0	0	0	0	0
	Retained Earnings	0	0	500	1000	1500	2000
	Distribution for Taxes		0	-200	-400	-600	-800
	Dividends		0	-300	-600	-900	-1200
	Common Stock	600	2001	2001	2001	2001	2001
	Equity	600	2001	2001	2001	2001	2001
	Total Liab & Equity	900	2301	2301	2301	2301	2301
Cash Flow							
			<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>
	Net Income		500	500	500	500	500
	Distribution for S Shareholder Taxes		-200	-200	-200	-200	-200
	Operating Cash Flow-Business		300	300	300	300	300
	Buyer's Pre-tax ROI	<u>Year0</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>
	Original Equity Investment	-2001					
	Selling Price @ Exit Multiple						2001
	Less Non-Operating Liabilities		0	0	0	0	0
	Pre-Tax Proceeds from Sale		0	0	0	0	2001
	Tax Distribution from Corp. to S-Shrhldr		200	200	200	200	200
	Dividend Distribution		300	300	300	300	300
	S Dividend Gross Up to Pre-tax		200	200	200	200	200
	S Undistribtd Erngs Gross Up to Pre-tax						0
	Taxes from S-Shrhldr to IRS		-200	-200	-200	-200	-200
	Pre-Tax Cash Flow	-2001	500	500	500	500	2501
	Buyer's Pre-Tax ROI =		25.0%				

<u>Valuation Summary</u>		2.40 EBITDA	Business Value		1200			
Price Multiple		2.40 EBIT						
<u>Income Statement</u>		<u>Year0</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>	
Sales		5000	5000	5000	5000	5000	5000	
EBITDA		500	500	500	500	500	500	
Other Expenses/(Income)		10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	
Expenses		0	0	0	0	0	0	
Taxable Income		500	500	500	500	500	500	
Corp. Taxes: State		0	0	0	0	0	0	
Corp. Taxes: Federal		200	200	200	200	200	200	
Net Income		300	300	300	300	300	300	
<u>Balance Sheet</u>		<u>Purch.</u>	<u>Opening</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>
<u>Assets</u>								
Cash		0	0	0	0	0	0	0
A/R		500	500	500	500	500	500	500
Inventory		400	400	400	400	400	400	400
Goodwill		0	600	600	600	600	600	600
Total Assets		900	1500	1500	1500	1500	1500	1500
<u>Liabilites &amp; Equity</u>								
A/P & Accrued		300	300	300	300	300	300	300
Retained Earnings		0	0	300	600	900	1200	1500
Dividends		0	0	-300	-600	-900	-1200	-1500
Common Stock		600	1200	1200	1200	1200	1200	1200
Equity		600	1200	1200	1200	1200	1200	1200
Total Liab & Equity		900	1500	1500	1500	1500	1500	1500
<u>Cash Flow</u>				<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>
Net Income				300	300	300	300	300
Operating Cash Flow-Business				300	300	300	300	300
<u>Buyer's Pre-tax ROI</u>		<u>Year0</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>	
Original Equity Investment		-1200						
Selling Price @ Exit Multiple								1200
Pre-Tax Proceeds from Sale		0	0	0	0	0	0	1200
Dividend Distribution		0	300	300	300	300	300	300
Pre-Tax Cash Flow		-1200	300	300	300	300	300	1500
Buyer's Pre-Tax ROI =			25.0%					