Glossary of Exit Planning Terms

Appraiser Certifications:

There are several organizations that offer professional accreditation programs for Business Appraisers. Candidates must meet a set of established criteria which demonstrate competency in the field of business appraisals. If you are seeking a valuation of your business, you should make sure that your appraiser holds at least one of the certifications listed below:

ABV - Accredited in Business Valuation (American Institute of Certified Public Accountants)
ASA - Accredited Senior Appraiser (American Society of Appraisers)
CBA - Certified Business Appraiser (Institute of Business Appraisers)
CVA - Certified Valuation Analyst (American Institute of Certified Public Accountants)
CFA - Chartered Financial Analyst (CFA Institute)

Baby Boomers:

Baby Boomers not only impacted business in America, they remodeled every aspect of society as they passed through it. They were born from 1945 (the end of World War II) through 1964. Although slightly exceeded in number by the Millennials, they had an outsized effect on the U.S. economy for over 40 years. They number almost 77 million or about 25% of the population.

Business Brokers:

Intermediaries who specialize in the sale of “Main Street” businesses. Typically, a business broker will prepare listing information, advertise, and communicate with prospective buyers. Some may request up front retainers, but the majority of a broker’s compensation is usually from a 10% to 12% commission on the sale.

Capital Gains Tax:

A lower rate than the tax on ordinary income, utilized on the sale of stock or of assets for which there is a substantial basis. The tax is levied on the profit realized on the sale of a business that was originally purchased at a cost amount that was lower than the amount realized on the sale. An important consideration when structuring a transaction.

Due Diligence:

The process of examining all the records and systems of a company before completing a sale. Due diligence typically includes some level of confirmation testing (audit) of financial reports, interviews with key personnel and outside relationships, and a review of all contractual obligations to establish the value of assets and liabilities and evaluate commercial potential.

EBITDA:

EBITDA is a commonly used acronym which stands for Earnings Before Interest, Taxes, Depreciation and Amortization. This is a cash flow measure that takes into consideration the non-cash expenses (interest, depreciation, and amortization) that are deducted as accounting entries from the pretax profits. It is often used as an indicator of a company’s financial performance.

Entrepreneurial Buyers:
A buyer class that includes individuals or small groups (partners) who are buying or looking to buy a Main Street company in anticipation of working full time to generate a living. Often a more financially prudent and less risky option than building a company from scratch, because the Main Street business has already been proven to generate paying customers.

ERISA:
ERISA is a commonly used acronym which refers to the Employee Retirement Income Security Act of 1974. It is the Federal law that establishes the minimum standards and attendant guidelines for tax advantaged retirement savings plans. In order to be funded with pre-tax dollars, an ERISA qualified plan must be open to all employees. (For more information see the U.S. Dept. of Labor ERISA webpage.)

ESOP:
An Employee Stock Ownership Plan (ESOP) is a federally regulated method for selling a business to its employees in a manner that is tax-advantaged to both seller and buyer. ESOPs require expensive compliance both during the transaction and ongoing afterwards. Therefore, they are seldom cost-effective for Main Street or lower Midmarket companies.

Family Business Office:
A professional management team dedicated to overseeing one or more wealthy families' investments. In recent years family offices have become more active financial buyers in their search for better returns. The single-family office manages the financial and personal affairs of one wealthy family while a multi-family office offers customized solutions and specialized expertise to several affluent families.

Fair Market Value:
The price agreed to between a willing seller and a voluntary buyer when both possess full information about the business and are under no constraints or pressure. The purpose of most business valuations is to try to estimate the Fair Market Value of an entity.

Financial Buyer:
A buyer class that includes any buyer such as a Private Equity Group or Family Office that is purchasing a business based primarily on the expected investment return. They are typically long-term investors looking for a solid, well-managed company and tend to only make changes in turnaround situations where companies are not profitable.

Generation X:
The tenth (Roman Numeral X) generation born as United States citizens which immediately followed the Baby Boomers. Although there is some debate, Gen X is most frequently defined as those born from 1965 through 1982. Sometimes referred to as America's neglected "middle child" because it is a generation bookended by two much larger generations, the Baby Boomers and the Millennials.

Growth Consulting Systems:
A documented process for improving the profitability and value of a business. Some of the most popular growth consulting systems include:

> EOS: The Entrepreneurial Operating System, created by Gino Wickman and outlined in the book Traction, is a system that seems to work especially well in smaller companies who have never used an organized planning system.

Growth Consulting Systems (cont'd):

Gazelles: A comprehensive system of online forms and support outlined in Verne Harnish's new book Scaling Up. Gazelles is an excellent system for fast-growing companies, technology based businesses, and those who seek to outgrow the neutral zone.

Maus Software: An Australian-based company, Maus provides software solutions that are catching on quickly among the exit planning community. They include some specific exit planning tools in their suite of business products.

VBS – the Value Builder System: This process grew out of John Warrillow's book Built to Sell. This approach is more focused on business metrics than on the personal objectives focus of exit planning.

Investment Bankers:

Investment Bankers work for financial institutions in the business of raising capital for companies, government and other entities. They act as intermediaries in the sale of mid-market businesses. While Investment Bankers raise capital, they more often search out qualified buyers and arrange controlled auctions.

LBO (Leveraged Buyout):

The purchase of a company by using its own balance sheet to finance (leverage) the purchase. The assets of the company being acquired are often used as collateral for the loans. It is a frequent methodology used in order for managers to buyout an owner.

M&A (Mergers & Acquisitions):

The overarching term for all activity surrounding the buying and selling of businesses, although it is more commonly associated with larger transactions. A merger means combining two companies to form a new company, while an acquisition is the purchase of one company by another in which no new company is formed.

Main Street:

The common term for companies with valuations and selling prices up to $3,000,000. They are what most people think of when discussing "small business," an operation where the owner(s) are completely involved with day to day functional responsibilities. Main Street businesses are usually sold to entrepreneurial individuals who are seeking full time employment as an owner.

Midmarket:

Companies valued between $3,000,000 and $50,000,000, or between Main Street businesses and large M&A interests. They generally have between fifty and a thousand employees. The middle market represents a significant part of the U.S. economy with one-third of private sector GDP employing approximately 25% of the total labor force.

Millennials:

Persons born after Generation X considered to be from 1983 through 2000. They are also sometimes referred to as Generation Y. They are the first to have come of age in the new Millennium. Millennials now number 75.4 million, surpassing the 74.9 million Baby Boomers (ages 51-69). Young immigrants have also been a factor in adding to the numbers of Millennials in the U.S.

Neutral Zone:
Companies whose value is too great to be affordable to an individual buyer, but who aren't sufficiently profitable to attract financial investors. Too big to be small and too small to be big these businesses have typically between $5M and $10M in gross revenue with a fair market value between $3M and $5M. They usually realize less than $1M in pretax profit.

NQDC (Non-Qualified Deferred Compensation):
Non-Qualified Deferred Compensation (NQDC) Plans are defined as any non-ERISA compliant compensation plan that is inherently discriminatory regarding eligibility. It can be either an elective or non-elective plan, agreement, method, or arrangement between an employer and an employee to pay the employee compensation in the future. For example, stock options for C-level executives.

Private Equity Groups:
Investment partnerships whose primary focus is the purchase and sale of businesses exclusively to produce returns for their investors. Selling to a private equity group (PEG) may be a great exit strategy for an owner who wants or needs to get substantial liquidity out of the business but wants to remain in operational control.

Quality of Earnings Audits:
A specialized due diligence audit most commonly used by Private Equity Groups. Its purpose is to discount earnings (and the resultant purchase price multiple) by identifying customer concentration or competitive risks, along with unrecognized liabilities such as employees' accrued vacation time.

SBA (Small Business Administration):
The US Small Business Administration (SBA) provides support to entrepreneurs and small business. It is a government-backed guarantor of banks' small business loans. The SBA does not lend money, but rather insures the primary lender via either its 504 (real estate) or 7A (business value) programs.

SDE (Seller's Discretionary Earnings):
Seller's Discretionary Earnings (SDE) is a Main Street approach to valuation determined by the total financial benefit derived from an owner's compensation and other company-paid benefits. It is the pretax and pre-interest profits before non-cash expenses, the owner's benefits, time investments, and non-related income or expenses.

Strategic Buyer:
A class of buyers considered an M&A level purchaser who buys a business for specific, differentiable products, services, technical knowledge, intellectual capital or contractual relationships. Their goal is to identify companies whose products or services can synergistically integrate with their existing P/L to create long-term shareholder value.

USPAP:
The Uniform Standards of Professional Appraisal Practice (USPAP) is the national organization that disseminates ethical performance valuation standards for all other certifications. Compliance is required for state-licensed and state-certified appraisers.

Virtual Equity:
Any of a variety of plans (e.g. Phantom Stock, Equity Appreciation Rights), intended to retain and reward key employees. These plans are typically characterized by awards based on organizational value, and qualifications for payouts over a lengthy time period or conditional on a change in ownership.