

GLOSSARY OF COMMON TERMS

This list is a collection of abbreviations, acronyms, terms and words, which a business Buyer or Seller may encounter. It is by NO means complete in terms one may encounter or in completeness of definitions. Nor does it contain more basic and obvious terms, which are assumed to be understood by the majority of the general business public. The definitions below are very loose interpretations and are not meant to be exact as one would find in a standard dictionary or accounting textbook, but rather intended to be understood in the context of buying and selling businesses.

ADDENDUM – anything added to a document, letter, agreement, or legal instrument – similar to an amendment. For instance, there may be several addendums that accompany an offer to purchase a business or real estate, such as a contingency addendum.

ADJUSTED EBITDA (Adj. EBITDA is often the abbreviation) – this is generally the net profit showing on the bottom line of a tax return or profit and loss statement; plus interest expenses on items which will be paid off at closing or items which a Buyer would not have, such as vehicles which are excluded from a sale, or bank loans which will not be assumed; plus federal and state income taxes expensed; plus depreciation and amortization; plus Seller's salary which is expensed (where there is a W-2 or 1099...;) plus Seller's personal perks which could be considered superlative to the operation of the business, such as Seller's life insurance, Seller's health insurance (perhaps the Buyer's spouse has other insurance which would cover the Buyer,); plus section 179 expenses; plus tax loss carry-forwards (again, non-cash in current year;) plus any one-time non-recurring costs (as in a new air conditioning system which won't need replacement for years;) plus any automobile expenses not necessary for the efficient operation of the business. (Note that there are certain items some Sellers will attempt to add back to cash flow which may or may not be legitimate add-backs to cash flow, but which lenders certainly will not consider as legitimate add-backs since the lender will not be auditing every invoice expensed. A Buyer could do so, but only if no is lender necessary.)

AFFDAVIT OF NO DEBTS AND LIENS – (See Bulk Sales Act)

ALLOCATION OF PURCHASE PRICE – generally when a Buyer and Seller assign a specific number of dollars to various components of a business purchase or business and real estate purchase. For example, the allocation might assign a certain dollar value to the furniture, fixtures and equipment; another portion of the purchase price to a non-compete agreement; another dollar amount to the inventory at cost; another dollar amount to leasehold improvements; another to goodwill (or the intrinsic value of a going concern); a portion to training and consultation and possibly the balance to the building and land if it is part of the sale.

A/P – Accounts Payables

A/R – Accounts Receivables

ASSUMED NAME – (sometimes referred to as "Fictitious Name") the name of the business. In most areas, the name is filed with the County Records Department and/or at the State Level. (See DBA)

BASE RENT – the minimum rent in a retail, office building or warehouse lease, before any lease provisions for common area maintenance, tenant's pro-rata share of real estate taxes and insurance, or any special advertising expenses as one might find in a major retail shopping mall. Most leases will have a base (beginning) year, after which the lease will call for tenant's pro-rata share of any increases in the extra expenses. Other building leases may contain a provision for a percentage of additional rent above the base rent if the business hits a certain dollar value of annual gross income (often termed a "percentage clause" or "percentage lease".)

BILL OF SALE – a legal document or instrument used to transfer personal property. A "business" is considered personal property. The Bill of Sale is signed by the Seller of the business at Closing. It is generally a document prepared by the escrow or Title Company as the case may be.

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BUSINESS VALUATION – determination of the fair market value of a business. A valuation differs from a business appraisal in many ways – primarily the cost and the fact that in an actual appraisal, the value of the equipment is researched to determine more exact fair market values.

BV (BOOK VALUE) – the value of the equipment and fixtures after depreciation has been taken on the balance sheet of a business. There are more concise and in depth definitions of this, but for the purpose of this glossary, this is a number that accountants will generally want to see. It may differ from the actual fair market value of the assets.

BULK SALE – a transfer in a whole or substantially all of the inventory and fixtures of a business, which is not in the ordinary course of business, such as the entire business.

BULK SALES ACT – State laws, which are to protect creditors against undisclosed sales of all or substantially all of a business's goods prior to receiving payables due creditors or vendors. In these cases, there will most likely be no financing. It requires certain notices prior to the sale and sets forth ways of voiding the sale (see Uniform Commercial Code.) Some states, such as Texas, have repealed the Bulk Sales Act. In this case, in lieu of the Bulk Sales laws, the escrow or title company will generally prepare an "Affidavit of No Debts and Liens" for the Seller to execute at Closing.

CAPITAL ASSETS – permanent assets such as machinery, buildings, land, fixtures, equipment, etc. Inventory is not included as a capital asset. Often used interchangeably with FFE (Furniture, fixtures and equipment) when there is no real property involved.

CAPITALIZATION RATE (CAP RATE) – A rate of return utilized to derive the capital value of an income stream, generally expressed as a percentage. It is merely one quick indicator of real estate value or business value, as it is basically a function of supply and demand – a reflection of the current market conditions.

Annual income or adjusted EBITDA divided by the cap rate equals value.

Generally accepted cap rates may vary greatly within different geographical areas, within different business industries, and within sub-areas, such as different neighborhoods of a particular city. In the business service sector, there are countless types of service companies, which could all have differing accepted cap rates for their specific company type. In addition, the generally accepted cap rates for one type of business may be one rate in Dallas, and a totally different rate in Chicago. The market cap rates are also in a continual state of flux, affected not only by all of the above, but also by changes in local, national and world economics, political and other conditions.

CASHIER'S CHECK – generally required as earnest money deposit on a purchase offer for a business. The Buyer will exchange actual cash, wired funds, or other good funds with the bank for a small fee. The bank will then give the Buyer a check, which is almost like cash. If the offer is not signed both ways, the Buyer can usually take the same check back to the bank for exchange for cash. In business purchases, it is generally not deposited until the offer is accepted. It is often not deposited with an escrow agency until the Brokers have been given the authority to open escrow, meaning the parties wish the escrow or title company to begin preparation of the closing documents and all of the contingencies are generally removed. (In pure real estate transactions the earnest money is generally deposited with the title company upon acceptance of the offer.)

CAVEAT EMPTOR – "Let the Buyer beware."

CLOSING – when all of the lien searches have been performed, the final documents prepared by the escrow company, the proofs of those documents have passed muster with the attorneys for all parties, the contingencies of closing have all been approved, the lease has been transferred, any legal incorporation work has been completed by the purchaser, when the purchaser brings the balance of the down payment or total purchase price to the escrow company or title company in the form of a cashier's check, wire-transferred funds, or via funds from a third party lender. In short, this is usually when the business is transferred from the Seller to the Buyer. If there is no third party lender, then this is also when the Seller is paid his/her proceeds, and the Buyer takes

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possession of the business. If a third party loan is involved, the loan generally takes two to three business days to actually fund.

CLOSING STATEMENT – a statement that spells out the financial settlements of debits and credits between the business or real estate Buyer and Seller. The Buyer and Seller will generally have separate statements.

CONTINGENCY – a clause in an agreement or contract that is only binding upon the occurrence of a stated event. For example, the sale of the business is contingent upon the Buyer obtaining an SBA Loan, or that the Buyer is satisfied with the books and records. These contingencies (sometimes termed “conditions”) generally have an expiration date in the agreement or contract, beyond which the contingency is considered to be removed or satisfied.

CURRENT ASSETS – also known as “liquid assets” which could easily be converted to cash. For instance, this would not include real estate, as real estate is not readily convertible within a few days.

CURRENT LIABILITIES – short-term debts or accounts payable to employees, vendors, etc.

DBA – “Doing Business As” – the assumed name and/or identification of ownership of the business. For instance, a corporation or an individual or partnership entity could have one name for the particular legal entity, but be doing business as another entirely different name, which is the name the public generally recognizes as the company name. Immediately following closing, the Buyer will file a notarized assumed name certificate with the county records department (and sometimes also with the state) taking with them in hand the signed and notarized “assumed name abandonment form” executed by the Seller.

DISCLAIMER – a hold harmless statement that puts one party on notice that it is not liable for information which it does not investigate and which would be impractical to investigate, as when one cannot be an investigator into accounting information when one is not an accountant. Or when a Seller gives a Buyer information, or the Seller gives the Broker information, who in turn gives the same information to the Buyer and the Broker is disclaiming any liability or responsibility for the accuracy of said information.

EBIT – business earnings before interest and federal or state income taxes. (also see EBITDA and Adjusted EBITDA)

EBITDA – business earnings before taking into consideration the interest expenses, federal and state income taxes, depreciation and amortization expenses (non-cash items.) Most business Sellers, Buyers and lenders accept the common practice of adding the non-cash expenses such as depreciation and amortization back into the profit to derive the true cash flow available.

FAIR MARKET VALUE (FMV) – what a willing Buyer is willing to pay and willing Seller is willing to sell for – neither party being under duress to buy or sell.

FFE – Furniture, fixtures and equipment. Leasehold improvements are often loosely included in the FFE values.

FINANCING STATEMENT – a recorded document filed generally in the Secretary of State’s office of the State, which puts the public on notice of a recorded lien against the fixtures and equipment of the business. This lien must be removed by the filing party prior to transfer of ownership of those assets or the business as a whole. (See UCC also)

FIXED ASSETS - items such as building structures, land, furniture, fixtures, and equipment, vehicles (or rolling stock.) Inventory and Supplies are in a separate category. Leasehold improvements are generally included in the fixed asset values. The leasehold improvements are especially important in businesses that require an extraordinary amount of plumbing, refrigeration, electrical lines, etc. For example, in a coin laundry purchase, the leasehold improvements could actually be a depreciable asset over a relatively short time. It depends on the tax laws at the time.

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FMV – FFE – fair market value of furniture, fixtures and equipment.

HOLD HARMLESS AGREEMENT – an agreement where one party agrees to repay another for any loss or damage suffered. Generally, a Broker's document will include multiple hold-harmless clauses, as a Broker does not investigate the accuracy, truthfulness or completeness of information it receives from a Buyer or Seller and therefore cannot be held liable for same.

INV - INVENTORY– items, which a business owner has purchased or manufactured available for sale to customers or clients.

L.I. – Leasehold Improvements, such as piping, built-in cabinetry, electrical, carpeting, or special built-in display components, etc.

L.O.I. – Letter of Intent to purchase – generally non-binding and unacceptable on the purchase of a small business. However, it is quite common in the middle market arena.

MASTER LEASE – a lease that contains the authority to control subsequent leases generally referred to as sub-leases. The one who holds the master lease is, in effect, one of the landlords, whether he/she owns the property or not.

MIDDLE MARKET – the lower end of M & A (Mergers and Acquisitions) where the company grosses between \$5 and \$50 million.

MONTH-TO-MONTH (A.K.A. “M – M” or “M to M” or Tenancy at will) – where there is no written lease, so the lessee can be evicted on short notice, generally thirty days or whatever is required in a particular state.

NDA - NON-DISCLOSURE AGREEMENT/CONFIDENTIALITY AGREEMENT – these are generally agreements, which the Sellers of businesses and often Sellers of commercial real estate will require to be executed by potential Buyers prior to disclosure of the location and sensitive and confidential information.

OCF - OWNER'S CASH FLOW – the current owner's true profit, excluding any discretionary expenses, personal expenses, owner's salary if a corporation, one-time non-recurring expenses, and/or non-cash items such as amortization or depreciation; or Seller's discretionary profit. (Has often been used synonymously with EBIT, EBITDA, Adjusted EBITDA, Seller's Discretionary Cash Flow, SDC, Seller's Discretionary Earnings, SDE, Normalized Adjusted Earnings.)

OFFER TO PURCHASE AGREEMENT – where the title to the inventory, fixtures and equipment of the business remain with the Seller, until the terms and conditions of the contract have been met, and all contingencies removed. Some Buyers will place a condition in this agreement specifying that once everything has been satisfied and the transaction is ready to occur that all parties will execute a more definitive asset (or other) purchase agreement.

PREPAID ITEMS – expenses of the business that are paid in advance and agreed between the parties to be pro-rated at closing. Examples are rent and Personal Property Taxes.

PRO-RATE – to divide taxes, rent, and possibly other prepaid items based on the percentage of time, whether of the current month of closing or the current year, by the Seller and Buyer.

R.E. – Real Estate

ROI (RETURN ON INVESTMENT) – the rate of return of total capital invested for the purchase of a business or real estate (for our purposes here) relative to the profits or adjusted EBITDA returned or assumed to be returned to the Buyer over a period of time, and is generally stated as a percentage.

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SBA (SMALL BUSINESS ADMINISTRATION) – the U.S. Federal Government entity (See link under small businesses for sale)

SBA LOAN FEES - generally 3% of the total loan, which is paid by the Borrower and goes directly to SBA. This is in addition to any Lender closing fees such as fees for business valuations, real estate appraisals, surveys, title policy, environmental appraisal fees, Lender packaging fees, etc.

SBA LOAN – a loan to an owner of a small business or individual business Buyer by a valid Lender (generally one who holds a “Preferred Lender” status.) This loan is generally 50% to 85% guaranteed by the SBA to the Lender in case of default.

SDC - SELLER’S DISCRETIONARY CASH FLOW – see Adjusted EBITDA, EBIT, EBITDA, OCF – Owner’s Cash Flow

SUBLEASE – a lease where the lessee can be the lessor, in effect, on a subsequent lease which differs from a straight out assignment of lease. The Landlord must approve in writing the tenant’s right to sublease to a new tenant. If the Seller is still responsible for the lease, he/she may require this. Or if the Seller (tenant) is holding a promissory note for the Buyer, it may also be required, so that the Seller would be in position to re-assume the role of business owner in the case of default.

UCC - UNIFORM COMMERCIAL CODE – the laws (each state has their own version), which regulate the transfer of personal property (a business.) For instance, in Texas, a UCCI is filed as a recorded lien against a business, which cannot be transferred until a UCCIII is signed by the Lienor (or Lender.) This is generally handled at closing by the Escrow Company or Title Company out of the proceeds from the Buyer. (Also see Financing Statement)

VALID – legally binding.