



5 Types Of Discretionary Earnings To Be Aware Of Before Selling a Business

by Peter C. King, VR Business Sales/Mergers & Acquisitions, CEO President

1. Owner's Salary

Most business owners do pay themselves some salary on the books. The key here is whether there are other members of the family included in the payroll expense, and whether or not these individuals serve a function in the business. (A buyer can only replace one salary, so be careful which salary(s) among the family members you include in DE.)



2. Discretionary Expenses

These are expenses that are not essential to the operation of the business but are a method of deriving income from a company. Examples include additional travel and entertainment expenses, additional utility bills, additional car expenses, etc. Sometimes, business owners contract for services and have both personal and business work done by accountants or legal counsel.

Depending upon the nature of a business, certain expenses may or may not qualify as discretionary. For example, the interest expense for a boat dealership is a "flooring" expense and a necessary expense for doing business. Very often, the interest for credit cards accepted shows up in this expense; another necessary item. However, the interest on a personal loan is discretionary.

Usually, it is a matter of having the expense explained by the seller. Items such as postage, dues and subscriptions, contributions, advertising, repairs, insurance, and garbage removal may or may not apply to the business and therefore, they need to be explained.

3. Non-Recurring Expenses

Non-Recurring Expenses are one-time charges and are not expected to occur again in the future.

4. Non-Cash Expenses

Non-Cash Expenses are those expenses that are accounting entries for depreciation or amortization. While they may be true values for financial purposes, we add them to our DE computation. (Investigate whether the depreciation is "paper" or "real," e.g. depreciation on delivery vehicles is usually at least 50% real; the trucks do deteriorate and will need replacing.)

5. Profit or Loss

The reported profit or loss of a business is added to or subtracted from the DE in order to get a final Discretionary Cash figure.



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