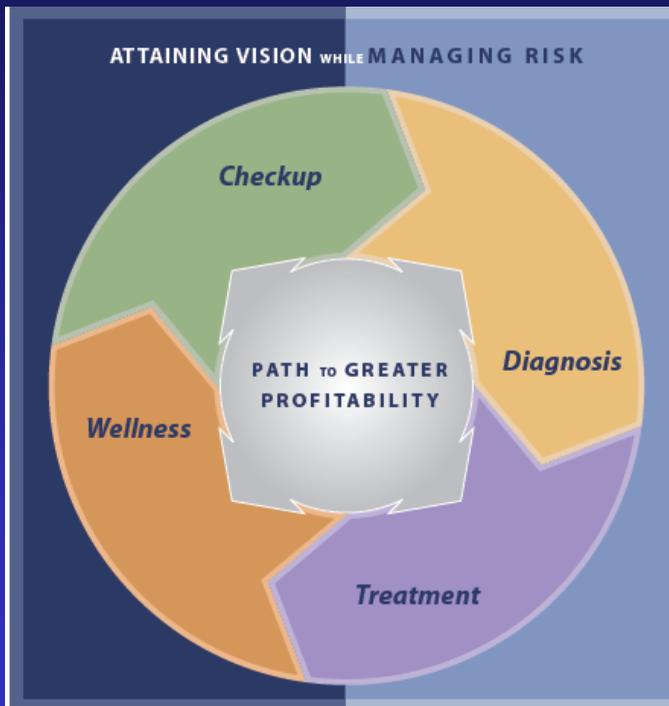


Executive Compensation - From Perspective of Your Client's CFO

Lorman Education Services
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About FiscalDoctor



Checkup – identify immediate issues

Diagnosis – thorough review of financials and systems

Treatment – implementation of best practices

Wellness – maintain financial health

What I am Going to Cover Today

- ◆ Strategic level values statement
- ◆ Financial Mission - Executive 5 questions to add value
- ◆ What to expect from your client's accounting resource
- ◆ Practical equity related tools
- ◆ Emotional side of re-vesting; claw back
- ◆ The emotional questions you want to ask your CEO or CFO client

Overview

- ◆ A lot of these handouts and what I say will sound basic. Therefore you will ignore it and increase time and costs to serve your client.
- ◆ My time pressures were so short that I had to install barebones systems and then add fuller functionality later.

THE STAGES OF A COMPANY'S DEVELOPMENT

	REVENUE	EMPLOYEES	KEY INDICATORS
1 RAW STARTUP	None (by definition)	0-50	<ul style="list-style-type: none"> a) Innovation as a priority b) Always in flux, high risk c) More unknowns than knowns d) Product or service looking to prove its market exists e) Everything is fragile
2 EARLY REVENUE	\$100 to \$5MM	5-100	Product delivered proving some value proposition, but still no proven sustainable or profitable business model.
<p>Most companies slow or stop growing here due to organizational and people limits. 100, 200 and 300 employees are critical hurdles. This is often the hardest leap to make which requires the most changes in the smallest period of time.</p>			
3 ESTABLISHED	\$500,000 to \$50MM	20 to 500	<ul style="list-style-type: none"> a) Profitable or clear path to profits based on scaling business. b) A proven market and value or price formula, with profits clearly available in a steady state world when scaled.
4 GROWTH EXPANSION	\$2MM to \$1 billion	50 to 1,000	Market opportunity is many times larger than the company and there is a desire and ability for significant market share and/or revenue growth.
5 MATURE	\$8MM to \$100+ billion	100 to X	<ul style="list-style-type: none"> a) Slow growth, stagnation of market or company, or focused on harvesting past investments. b) Slow/little change in market and/or company or commoditization of products forcing a focus on costs above innovation. c) Consolidation of competitors and focus on finding new distribution and/or leverage.

Corporate Funnel - Vision to Tactics



Not All Values Are Created Equal

Fictional company (Partial list of values):

Value	Weight	Measures
Customer Focus	20%	<ul style="list-style-type: none"> • Market share • Customer satisfaction survey • Data on customer loyalty
Innovation	5%	<ul style="list-style-type: none"> • New products and services
Quality	15%	<ul style="list-style-type: none"> • Service calls • Product recalls / alerts • Returns
Developing others	2%	<ul style="list-style-type: none"> • Promotions and transfers of direct reports • Attendance at training
Safety	2%	<ul style="list-style-type: none"> • Accident data • Illnesses
Environment	4%	<ul style="list-style-type: none"> • Environmental Index
Teamwork	10%	<ul style="list-style-type: none"> • Employee climate surveys • Interviews / Focus groups • Turnover / absenteeism reports
Financial	The rest %	<ul style="list-style-type: none"> • More traditional factors

Key points:

- Your company's real values show up in weight placed upon value categories
- Soft Values can be made tangible by measuring outcomes

Values need to link to short-term and long-term incentives

Your Financial Mission For the Company

- ◆ Why is this a great opportunity?
- ◆ Why are we building this company?
- ◆ How do we fund next 2 quarters?
- ◆ Where are we financially?
- ◆ What else do you want discussed?

What to expect - levels of Accounting Staff

Position Description

CFO Person who makes the financials understandable. Range from True Business Partner to Technician at \$90k to \$250k. Part-time CFO range from \$100 to \$400 an hour

Controller Working manager for accounting department. Range from CFO Track to Technician at \$60k to \$125k. Part-time Controller range from \$50 to \$150 an hour

Accountant Person who gets the work done, possibly certified or degreed. Range from \$30k to \$50k

Bookkeeper Person who keeps the books. Range from minimal bookkeeping skills and clerical duties to Office Manager capabilities for early growth

CFO – Duties, When to hire, Where to Find

Typical Duties:

- ◆ Managing the Controller, or Accountant(s) and Bookkeeper(s)
- ◆ Can sign checks in addition to or instead of Controller or Owner
- ◆ Approves Financial Statements
- ◆ Approves journal entries
- ◆ Implements more professional financial and accounting systems
- ◆ Coordinates with external CPA on tax returns, compilations or audits
- ◆ Create policies and procedures for implementation
- ◆ Safeguards assets
- ◆ Manages budgeting process
- ◆ Creates sophisticated cash management
- ◆ Strategic applications of budgeting and planning
- ◆ Manages accounting and finance functions
- ◆ Sometimes manages administrative functions or purchasing
- ◆ Upgrades product costing or bidding process
- ◆ Interfaces with bankers and other financing sources
- ◆ Suggests optimal financing options
- ◆ Can manage information technology in non technology companies
- ◆ Interface with external professionals on insurance, compensation design, and taxes
- ◆ Becomes a key member of executive team

When to hire on more than an outsourced basis:

- ◆ Basically when the company grows enough that the amount being spent on the external CPA or part time CFO suggests this work should be brought back in house. Often external equity financing sources will require this position be filled and may suggest specific candidates. Other deciding events may be one or more of the following: speeding up financial statements, more sophisticated cash flow monitoring, budgets or variance analysis is needed; your banker or CPA firm is telling you the position is needed; owner wants to leverage their time with a key number two person.

Where to find this person:

- ◆ The best way to fill all the accounting positions is referral from existing CPA, law firm, or interim CFO, or your prior experience. A recruiter specializing in executive level financial positions adds value in situations like specialized industries, substantial growth, or major financing needs.

Controller– Duties, When to hire, Where to Find

Typical Duties:

- ◆ Manages bookkeeper
- ◆ Handles Executive Payroll
- ◆ Can sign checks prepared by bookkeeper
- ◆ Signs Sales Tax returns
- ◆ Creates the more difficult journal entries
- ◆ Prepares Financial Statements
- ◆ Approves customer credit limits
- ◆ Is responsible for payroll processing
- ◆ Implements basic financial and accounting systems
- ◆ Can coordinate with external CPA on tax returns, compilations or audits
- ◆ Implements policies and procedures
- ◆ Creates non standard reports, including variance reviews
- ◆ Handles insurance and risk management with assistance
- ◆ Begins safeguarding assets
- ◆ Creates budgets
- ◆ Inventory overview with assistance

When to hire on more than an outsourced basis:

- ◆ Basically when the company grows enough that the amount being spent on the external bookkeeper, CPA or part time controller or part time CFO suggests this work should be brought back in house. Other deciding events may be one or more of the following: financials are received more than 15 working days after month end, budgets are desired, variance analysis is needed, need to speed up accounts receivable collections, or your banker or CPA firm is telling you the position is needed.

Where to find this person:

- ◆ The best way to fill all the accounting positions is referral from existing CPA, law firm, interim Controller or CFO, or your prior experience. In other cases like specialized industries, a recruiter specializing in mid level accounting positions adds value.

Bookkeeper – Duties, When to hire, Where to Find

Bookkeeper – person who keeps the books

Typical Duties:

- ◆ Maintains the basic accounting records
- ◆ Handles vendor statements and invoices
- ◆ Writes checks for another person to sign
- ◆ Balances checkbook and reconciles bank statement
- ◆ Maintains payroll records and sometimes payroll files
- ◆ Invoices Customers
- ◆ Maintains Accounts Receivable
- ◆ Makes general ledger entries set up by others
- ◆ Prepares Sales Tax Reports
- ◆ Fills in for receptionist
- ◆ Prints canned financial statements and reports

When to hire on more than an outsourced basis:

- ◆ Basically when the company grows enough that the founder no longer has time to handle basic bookkeeping, or by temperament is not suited for handling basic checkbook and records.

Where to find this person:

- ◆ The best way to fill all the accounting positions is referral from existing CPA, law firm or your prior experience.

Practical Equity Related tools

- ◆ Valuation effect factors
- ◆ Distribution of proceeds
- ◆ Cap table example
- ◆ Five questions benchmark
- ◆ 83 (b) election and cover letter

Valuation Projections Effect Factors

Target

Valuation based on year 5 projections of after tax income at various multiples

Year 5 revenues	21,000,000
Year 5 EBITDA	3,780,000
Year 5 after tax net income	3,150,000

<u>Multiple of PE</u>	<u>Projected value</u>	<u>Multiple of EBITDA</u>	<u>Projected value</u>	<u>Multiple of revenues</u>	<u>Projected value</u>
3	9,450,000	4	15,120,000	0.75	15,750,000
4	12,600,000	5	18,900,000	1	21,000,000
5	15,750,000	6	22,680,000	1.5	31,500,000
6	18,900,000	7	26,460,000	2	42,000,000
7	22,050,000	8	30,240,000	2.5	52,500,000
8	25,200,000	9	34,020,000	3	63,000,000

Value does not include distribution of cash and AR less payables
PE does not reflect premium to strategic buyer, who we intend to sell to

Obtain input values from your CPA or banker.

Distribution of Proceeds

Input sectors		Yield recap table - simple annual compounding
Investment	3,350,000	
Common override	0.2	
Sales value at time period selected	20,000,000	

Table recaps showing first dollars to preferred investors at different return rates and time periods

value today

guaranteed return %	Years				
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>
0.08	3,618,000	3,907,440	4,220,035	4,557,638	4,922,249
0.1	3,685,000	4,053,500	4,458,850	4,904,735	5,395,209

at discount
rates
3,350,000
3,350,000

guaranteed multiple approach					
2	6,700,000	6,700,000	6,700,000	6,700,000	6,700,000
3	10,050,000	10,050,000	10,050,000	10,050,000	10,050,000

Investor gets first dollars as shown above and then share in prorata allocation to common on remaining value.

Proceeds estimate:	Net sales value of	20,000,000
	Less allocated proceeds of (input value from tables above)	
	say 10% at end of year 4	4,904,735
	Subtotal available to common	15,095,265
	Additional dollars available to preferred	3,019,053
	Total proceeds to preferred	7,923,788

Obtain input values from your CPA or banker.

Cap Table Example

Potential Cap Table																		
			Prefunding		Core team vesting (2)		Pool options (3)		Subtotal		F & F cash		Subtotal		Preferred stock		Total %	
	Shares	Value	Shares	Value	Shares	Value	Shares	Value	Shares	% owned	Shares	Value	Shares	% owned	Shares	value	Shares	owned
A	1,900,000	minimal	88,672	minimal	150,000	minimal			2,138,672	52.55%	339,167	250,000	2,477,839	54.52%	0		2,477,839	36.87%
B			50,672	minimal	300,000	minimal			350,672	8.62%	67,833	50,000	418,505	9.21%	0		418,505	6.23%
Core team					550,000	minimal			550,000	13.51%	67,833	50,000	617,833	13.59%	0		617,833	9.19%
Early team shares (1)			70,000	minimal					70,000	1.72%	0		70,000	1.54%	0		70,000	1.04%
Early shares (1)			260,656	minimal					260,656	6.40%			260,656	5.74%	0		260,656	3.88%
Future hires (2)							700,000		700,000	17.20%	0		700,000	15.40%	0		700,000	10.42%
External investors - A									0	0.00%	0	0	0	0.00%	0		0	0.00%
External investors - B									0	0.00%	0		0	0.00%	2,175,027	3,350,000	2,175,027	32.37%
									0	0.00%	0		0	0.00%	0		0	0.00%
Total	1,900,000	0	470,000	0	1,000,000	0	700,000	0	4,070,000	100.00%	474,833	350,000	4,544,833	100.00%	2,175,027	3,350,000	6,719,861	100.00%
Shares					3,370,000				4,070,000		4,544,833				6,719,861			
Price per share									0.74		0.74		1.54		1.54			
Company value									3,000,000		3,350,000		7,000,000		10,350,000			
1 Shares are split into 2 groupings																		
2 Core team vesting shares are based on pre money company value (4 year vest) minimal																		
3 Follow up options are a pool set aside with strike price to be determined																		
4 Friends and Family round is based on pre money valuation of 3,000,000																		
5 External investors round preferred with guaranteed return - uses company pre money value on common 7,000,000																		
# of shares of common equivalent to be allocated to preferred 2,175,027																		

Gary's Five Question Benchmark

- ◆ Gary Patterson's Favorite Questions For Expansion Thinking - provides 5 honed questions to focus Executive Team discussions on the forest and not the trees. Clients have been extremely pleased with the thought process this generates for both attaining stretch goals and recognizing earlier dangerous risk situations. With early detection and follow up, cash shortages, inventory quality issues, pricing mistakes, and margin issues can often be addressed to avoid potential disasters. The value of my proprietary expansion thinking process can range dramatically with how seriously your company embraces this thought process using my tested and proven concepts.

Gary's Five Question Benchmark

- ◆ What are the three best opportunities we could create longer term and what do we need to do to best pursue those opportunities?
- ◆ What are the top three concerns you have about meeting the 2008 budget submitted?
- ◆ What actions can we take to minimize the risk of those concerns on the 2008 budget?
- ◆ What are the three top longer term risk area concerns of the Company today and how would the Company react if those concerns materialized?
- ◆ What are the three most crucial infrastructure issues we face over the next one or two years?

83 (b) cover letter example

- ◆ DATE
- ◆ CERTIFIED MAIL, RETURN RECEIPT REQUESTED
- ◆ CERTIFIED MAIL # _____
- ◆ Internal Revenue Service Center
- ◆ Andover, MA 05501 – 0014
- ◆ RE: Section 83(b) Election for: INSERT NAME, ADDRESS, AND SOCIAL SECURITY NUMBER HERE
- ◆ Dear Sir or Madam:
- ◆ Please find enclosed 83(b) Elections for the above-mentioned taxpayer. I have enclosed an additional copy of this letter and the Election. Please date and time stamp each copy and return them to me in the self-addressed, stamped envelope that I have enclosed.
- ◆ If you should have any questions regarding this matter, please contact me at XXXXXXXX.
- ◆ Very truly yours,
- ◆ TYPE YOUR NAME HERE AND HOME ADDRESS PRINT OUT AND SIGN.

Consult w Your Professional 83 (b)

- ◆ Election to Include Value of Restricted Property in Gross Income
- ◆ in Year Restriction Placed on Property Under IRC § 83(b)
- ◆ The undersigned hereby elects pursuant to §83(b) of the Internal Revenue Code with respect to the property described below and supplies the following information in accordance with the regulations promulgated thereunder:
 - ◆ 1. The name, address and taxpayer identification number of the undersigned are:
◆ Name: Address: SSN:
 - ◆ 2. Description of property with respect to which this election is being made:
◆ XXXXXX shares of Common Stock (the "Shares"), par value of \$.01 per share, of COMPANY NAME, a _____ corporation.
 - ◆ 3. The date on which property was transferred was _____.
◆ The taxable year to which this election relates is calendar year 200X.
 - ◆ 4. The nature of the restriction to which the property is subject is:
◆ The Shares are subject to repurchase by COMPANY NAME. at the taxpayer's original purchase price for such Shares in the event the taxpayer ceases to be employed by COMPANY NAME by a certain date, as set forth in the stock restriction agreement.
◆ The taxpayer may not transfer any and all of his Shares until such Shares are no longer subject to repurchase by COMPANY NAME.
 - ◆ 5. Fair market value at date of transfer:
◆ The Shares at date of transfer had a fair market value of \$XXXX per share.
 - ◆ 6. Amount paid for property at time of transfer:
◆ The amount paid by taxpayer for the Shares at the time of transfer was \$XXXX per share.
 - ◆ 7. Furnishing statement to employer:
◆ A copy of this statement has been furnished to the persons required by Section 1.83-2(d) of the Treasury Regulations.
- ◆ Date: _____

- ◆ Name:

Other Resources

- ◆ For more details on the stages of growth - www.CLevelEnterprises.com
- ◆ For more information on strategic values - www.businessadvance.com

See Booklet For Additional Items



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Your Questions And CFO Hot Seat

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