M and A TERMS

A Reference Guide

TITAN
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Add-on or Tuck-in

This refers to a company that is added by a private equity firm to one of its platform companies, or by a strategic buyer looking to add to its current consolidation investment strategy. An add-on acquisition can provide complimentary services, technology or expansion into the existing geographic footprint which can be quickly integrated into the existing infrastructure, or it could be a diversification of products, geographies, and customers, which would further extend the reach of the buyer. A tuck-in acquisition, often referred to as a "bolt-on acquisition," is a type of acquisition in which the acquiring company merges the acquired company into a division of the acquiring entity.

Blind Profile

Teaser: the anonymous profile of the company that is sent to potential buyers. The aim is to determine whether such a purchase could interest them without the identity of the company being disclosed. This is usually prepared by an Investment Banker or M&A Advisor.

CFDF or DFCF – Cash Free Debt Free

This is when an acquirer buys another company, the transaction will be structured such that the buyer will not assume any of the debt on the seller's balance sheet, nor will the buyer get to keep any of the cash on the seller's balance sheet. The seller gets to keep the cash that is on their balance sheet at the time of closing, except for a generally negotiated amount of "operating" cash that is considered a minimum amount that needs to transfer over in the sale to keep the operations of the acquired business running smoothly but must pay off all obligations (debt).

CIM - Confidential Information Memorandum

The CIM is prepared early in the sell-side process. It provides an overview of the company, including summary financial statements, metrics, KPI's and customer data and is designed to put the seller in the best possible light while providing sufficient detail to the buyers so they can prepare an initial IOI or LOI.

Data Room

A location or space (may also be an electronic space) in which potential purchasers can get access to specific confidential data concerning the company/business. By providing the buyer (and its advisors) with access to this space, the buyer will have the opportunity to read these documents and to form a picture of the company. Also referred to as a Virtual Data Room (VDR).

Definitive Agreement

It's known by many other names, including "stock purchase agreement" and "definitive merger agreement" and so on and so forth. But it does the same thing in each case: it spells out the finalized deal terms that the buyer and seller are agreeing to. Unlike a "Letter of Intent" (LOI), which is a preliminary document potential buyers might send over when thinking about buying a company, the Definitive Agreement is… definitive. Final. The end.

Dry Powder

Can also refer to cash reserves kept on hand by a company, venture capital firm or individual to cover future obligations, purchase assets or make acquisitions.

Earn-out

An earnout is part of a sale transaction where part of the price to be paid is conditional on future performance. This performance is usually tied to either revenue, gross profit margin, customer retention and/or employee retention. Most earnout periods last from 1 – 3 years. And earnout amounts can be calculated either on an annual, bi-annual, or quarterly basis. However annual is most common.

EBITDA - Earnings Before Interest Taxes Depreciation and Amortization

EBITDA is a measure of cash-flow that excludes the capital (or debt) service of the business, which helps with comparability from one transaction to another. A multiple of EBITDA is the most commonly used valuation metric for private companies.

Escrow

An escrow is a financial instrument held by a third party, typically a lawyer, on behalf of the other two parties in a transaction. The funds are held by the escrow service until it receives the appropriate written or oral instructions or until obligations have been fulfilled.

EV or TEV - Enterprise Value or Total Enterprise Value

These economic measures reflect the market value of a business. Unlike EBITDA, it includes the debt of a company and subtracts the cash and cash equivalents. TEV can be used to compare two companies with different levels of debt and equity.

Exclusivity (No-Shop) Requirement

A contractual requirement that prevents a company from soliciting or negotiating other deals for a specified period of time, while it is exclusively negotiating with a potential investor, group of investors or acquirers. This is usually 90 days and is stated in the LOI.

FCF - Free Cash Flow

FCF is a financial metric that includes cash flow generated from operations, minus annual capital expenditures required by the business (maintenance capex). This is a key metric used by buyers to evaluate a business. Free cash flow is usually calculated on a before tax basis.

FOs - Family Offices

FOs manage the wealth of investors and their families. These high-wealth individuals or families invest their own money into companies. They do not raise capital from outside investors. Each office's sole focus is investing the assets of one family (single-family office or SFO) or sometimes multiple families (multi-family offices or MFOs).

HB - Hold Back

A hold-back is cash kept back in an escrow account, usually for 12 months, and is there in case there are any unaccrued or unanticipated liabilities or expenses that arise post sale that should have been taken care of by the seller prior to the close if they were known. It can also cover items such as open accounts receivables being collectible, or customers being retained during that time period.

Heads of Agreement/Heads of Terms

An agreement in principle (also called a Letter of Intent (LOI) or Memorandum of Understanding (MOU)). This document can also refer to a binding list of basic elements that will be covered in more detail in a Share Purchase Agreement (SPA).

Indemnification "Baskets" and "Caps"

The Purchase Agreement will require sellers to provide relief if a buyer suffers losses due to a breach of representation. Typically, the indemnification arrangement will include minimum indemnification thresholds and limitations customarily referred to as baskets and caps. The cap refers to the maximum amount of remuneration a Buyer can receive for losses caused by a Seller representation breach.

Independent or Fundless Sponsor

An independent or fundless sponsor is a type of capital group or individual seeking acquisition candidates without having the equity financing required to complete the transaction up front (hence, they are "fundless"). Fundless sponsors raise the equity required to fund an acquisition after they have executed an LOI.

IOI or EOI - Indication of Interest or Expression of Interest

An IOI is a non-binding letter prepared by the buyer to the seller in which the main purpose is to express a genuine interest in purchasing the company, but the issuer hasn't yet had the opportunity to review sufficient data (due diligence) regarding the company. An IOI will offer an approximate price range. An IOI may be issued in advance of an LOI if the buyer is really serious, there are other buyers also interested and there is a sense of urgency to getting some information into the sellers' hands. An IOI will also give you an idea of who is serious and who is not.

LMM - Lower Middle Market

Lower middle market refers to the lower end of the economy's middle market segment, which is measured in terms of the firms' annual revenue. Firms that are grouped under the lower middle market category realize an annual revenue that ranges from $5 million to $50 million. Most LMM companies are represented by M&A Advisors.

LOI - Letter of Intent

The LOI is a document that outlines the preliminary terms of an agreement. While this is typically a non-binding document in most respects (except non-disclosure and non-compete), it is important to list out the key aspects of the deal in this document as it will serve as the foundation of the definitive purchase agreement. Once an LOI is accepted it typically prohibits the seller from speaking with other buyers for a specified time period: An IOI does not. A Memorandum of Understanding (MOU). A MOU is very similar to a LOI but is used when there are more than two parties involved.

M&A Advisor

Merger and acquisition (M&A) advisors provide guidance to other companies that intend to buy, sell, or restructure their firms. M&A advisors perform most of the services you would expect from an investment banker (i.e., prepare a teaser, confidential information memorandum, solicit buyers/sellers and provide valuations, etc.) They are, however, not licensed by the SEC or are a member of a FINRA certified (Financial Industry Regulatory Authority) firm. Most M&A Advisors work in the LMM where it is too costly to retain the services of an Investment Banker.

MRR/ARR - Monthly Recurring Revenue and Annual Recurring Revenue

These are terms used mostly in respect to revenue when dealing with hosted solutions or Software as a Service (SaaS) revenue or Anything as a Service (AaaS).

Normalized Earnings

Normalized earnings are adjusted to remove the effects of seasonality, revenue, and expenses that are unusual or one-time influences. This is also referred to as EBITDA adjustments.

Platform Company

This is the initial acquisition made by a private equity firm in a specific industry or investment type. This acquisition will serve as the foundation for a roll-up of other companies acquired in the same industry. Most private equity firms will find four to six platform companies for each fund, and then grow these platform companies both organically and through acquisition.

Portfolio Company

A company that has received an investment from a private equity firm or fund is said to be a portfolio company of that venture capital fund. Portfolio companies tend to be larger (in excess of $20M) and other companies (tuck-in's) are added to increase the size and offering of a portfolio company.

Private Equity Buyer

A private-equity firm is an investment management company that provides financial backing and makes investments in the private equity of startup or operating companies through a variety of loosely affiliated investment strategies including leveraged buyout, venture capital, and growth capital.

QofE - Quality of Earnings Report

This is a report prepared typically by a CPA firm during the due-diligence period. This report (either paid for by the buyer or seller) provides a detailed analysis of all the components of a company's revenue and expenses, and provides key analysis of the customer revenue, working capital, EBITDA adjustments or normalizations. While not an audit or a review, it does focus specifically on the key aspects a buyer would want to know about when purchasing the company. It also assesses the sustainability and accuracy of historical earnings as well as the achievability of future projections. Many times, this report is at the request of the board of directors, or of a private equity firm funding an acquisition for a strategic buyer in their portfolio.

Representations and Warranties

Representations and warranties is a term used to describe the assertions that a buyer and/or seller makes in a purchase and sale agreement. Both parties are relying on each other to provide a true account of all information and supporting documents to close the transaction. In this section, both sides have to state certain facts ("representations" or "reps") and then "warrant" that each one is true. This is almost always more extensive for the seller – they need to be in compliance with taxes, regulations, intellectual property laws, internal controls for accounting, contracts, and so on. This is also usually the last and usually time-consuming part of the agreement for the seller.

Retrade

The process of retrading is, in my opinion, a horrible last-minute attempt to change something in the purchase agreement often when you are down to the wire ready to close. This most often comes up as a "surprise" or "discovery" during diligence where new and previously unknown risks are used by the buyer to justify reducing the price. Some firms have a bad habit of throwing out big numbers with their IOI's and LOI's to get deals signed up, only to retrade multiple times in diligence to get to the value they actually wanted. This is not a common practice for most reputable PE firms, but something to watch out for none-the-less.

Second Bite at the Apple

A second bite at the apple, in the case of Private Equity (PE), means selling part of the business and then working with the private equity partner to create value and sell the remaining holding in the company, which is likely a smaller percentage, at potentially an even a larger amount than the first.

SME – Main Street Firms

These are companies with revenue lower than $5 million. These companies are typically represented by either a Business Broker or M&A Advisor.

SPA - Share Purchase Agreement

A Share Purchase Agreement is the definitive agreement that finalizes all terms and conditions related to the purchase and sale of the shares of a company. It is different from an Asset Purchase Agreement ("APA") where the assets (not the shares) of a company are being bought/sold.

Strategic Investor

Individual investors or firms that invest with the goal of acquiring strategic advantages rather than simply financial returns. They are usually competitors, customers, vendors, or other companies with similar interests.

Tail Period

The tail period is a period of time after the termination of the engagement during which, upon the completion of a transaction, the investment banker would still be entitled to its fee.

Tipping Basket and Deductible Basket

There are two distinct types of baskets: the deductible basket and the tipping basket. With a **deductible basket**, the buyer can only recover those losses or damages that are in excess of the agreed upon basket amount. For example, if the parties agree upon a deductible basket amount of $100,000, the seller only has to indemnify the buyer for losses or damages that exceed $100,000. The buyer is responsible for the first $100,000 of losses or damages. With a **tipping basket**, once losses or damages exceed the agreed upon basket amount, the buyer is indemnified for the full amount of the losses and damages. So, if the parties agree upon a tipping basket amount of $100,000, once the losses or damages exceed $100,000, the buyer can recover the full amount of such losses, not just those in excess of $100,000.

TTM or LTM - Trailing Twelve Months or Last Rolling Twelve Months

Most buyers want to see the most recent annualized information. While the calendar or fiscal year end numbers are important, there may be many months in between year end and when buyers are looking at the company. Providing TTM is a common request for financial statements and other company data.

UMM — Upper Middle Market

The upper middle market includes companies that are subcategorized under the broader middle market, with revenue or enterprise values ranging from $500 million to $1 billion. UMM companies are most likely represented by Investment Bankers.

Working Capital

Working capital is the sum of the customers, suppliers, stocks and other current assets and liabilities necessary for the day-to-day operations of the company. Usually, sellers need to leave at least one month or more of working capital in the company at close.

YOY - Year Over Year

This is really the process of comparing one year over another year, both from a financial statement perspective as well as other management data. Common YOY metrics are revenue, sales, receivables, payables, inventory, customer counts, etc.

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