LAMANNA®
CONSULTING GROUP

Demystifying M&A Jargon

Rev. 08/2023

Demystifying M&A Jargon

A Newcomer's Glossary of the Language of Mergers and Acquisitions

If you have never been part of an M&A process (either as a seller or a buyer), some terms that you might not understand may come up during the process.

This glossary starts with a definition of M&A, then clarifies other terms that are related to selling or buying a small- to mid-sized business.

M&A (Mergers and Acquisitions): A general term that refers to how companies transfer or combine ownership and assets.

- A **merger** is a voluntary fusion of two companies into an entirely new legal entity.
- An **acquisition** occurs when one company gains control over another company by purchasing 50% or more of another company's assets or shares.

Assets: Items of value owned by a company**.**

- **Tangible assets** include physical items such as land, buildings, equipment, or stocks.
- **Intangible assets** are non-physical items, such as intellectual property rights (e.g., patents, copyrights, trademarks), monies owed, mineral rights, goodwill, and contracts that economically benefit the business. **Goodwill** refers to factors such as the company's reputation, brand recognition, and customer loyalty.

Asset Deal: An agreement in which the acquiring company gains ownership of some or all of the assets of the target company.

Bankruptcy: The legal process through which entities that cannot repay debts to creditors may seek relief from some or all of their debts.

- In **Chapter 7 bankruptcy,** the business ceases operations, a trustee sells all of its assets, and then distributes the proceeds to its creditors. Any residual money goes to the company owners.
- In **Chapter 11 bankruptcy**, a business owner creates a plan for repayment and/or reorganizes and restructures debts. Normal business operations continue.

Business Broker: An individual that represents business owners who are considering selling their businesses. Brokers offer different types of advisory services to help business owners through all phases of the M&A process. Services could include introducing sellers to prospective buyers, estimating the value of a business, advertising the business for sale without identifying it, managing the initial interviews and negotiations, facilitating due diligence, and assisting with the business sale.

Business Valuation: The process of determining the value of a business. The value will be affected by the methods used to determine value and the date at which the value was calculated.

CapEx: In an M&A transaction, CapEx (or Capex) typically means Capital Expenditure. It represents the funds that a company invests in acquiring or upgrading physical assets, such as equipment, property, or facilities. Understanding the CapEx involved in an M&A deal helps evaluate the financial implications and potential synergies between the merging entities.

CIM (Confidential Information Memorandum): The "pitchbook" the seller's advisory firm produces to market the seller's business to potential buyers. The seller's advisory firm sends a CIM to potential buyers who responded to a brief investment teaser document that didn't name the company being sold. The CIM names the company being sold and provides an overview of its products and services. It also includes information about the company's ownership, management team, physical locations, production equipment, workforce, competitors, earnings history, and other relevant details.

Commercial Real Estate Clause: Outlines the terms and conditions related to any properties owned or leased by the target company in an M&A transaction. It addresses issues such as:

- property valuation
- transfer for ownership or lease
- rights of assignment
- lease terms
- potential liabilities associated with the real-estate assets.

Conglomerate: Corporation made up of several different, sometimes unrelated businesses. The conglomerate is the company that owns a controlling stake in a number of smaller companies that conduct business separately and independently.

Consulting Agreement: Contract that defines the relationship between a consultant and a client. It describes the scope of the services the consultant will (and will not) provide, how and when the consultant will be paid, rights to intellectual property, limits on liabilities, and provisions for terminating the agreement.

Deal Flow: The term financial professionals use to describe the rate at which business proposals and investment pitches are received. The pitches typically come from entrepreneurs or companies in which the fund is already invested. Or attorneys, accountants, or advisors who are familiar with the group's investment criteria sometimes make pitches.

DCF (Discounted Cash Flow): A business valuation method that calculates the present value of all future cash flows from a target company.

Divestiture: When a public or private corporation sells off business units that aren't directly related to its core business.

Due Diligence: A thorough review of the business before the sale is completed. The due diligence process examines criteria, such as the company's:

- target markets
- customer base
- growth prospects
- accounting practices
- profitability of each profit line
- existing facilities
- expansion plans
- competitors
- pricing strategies
- financial history
- labor relations
- legal issues
- environmental compliance
- marketing practices
- inventories
- suppliers
- strategic partnerships.

The goal of due diligence is to avoid unpleasant and costly post-sale surprises. In certain circumstances, the due diligence is regulated. In other situations, the buyer has a firm list of criteria that the seller must address.

Earn-out: A negotiable provision in the purchase agreement that makes a portion of the final sales price dependent on the achievement of certain objectives, such as forecasted growth in revenues. An earn-out is a way for the buyer to keep a seller engaged during the post-sale transition period. It provides the seller with an incentive to meet performance expectations.

EBITDA (Earnings Before Interest, Tax, Depreciation and Amortization): Banks and private-equity groups use this number to estimate the operating cash flow of a business. EBITDA reflects revenues from sales minus the cost of goods sold (COGS) and the (SG&A) sales, administrative, general expenses required to produce those revenues. EBITDA does not include the current value of equipment used to make or deliver the products or services.

EBITDA is a common measurement of the financial performance of a company because it indicates how much a company might have earned based on their own decisions. The EBITDA number strips out interest, tax, depreciation, and amortization because these costs will vary from place to place based on decisions made by government officials, lenders, and regulators.

EBIT (Earnings Before Interest and Taxes): A measure of a firm's profit that includes all income and expenses (operating and non-operating). It does not include interest or income tax expenses.

Equity: Also referred to as shareholder's or owner's equity, this is the book value of the assets less the liabilities of the company.

Escrow Agreements: Funds that are held by a third party for an agreed-upon time period until certain issues are resolved or finalized. Most M&A transactions have escrow account clauses. Common examples of escrow arrangements include: an escrow to cover working capital closing assumptions (see Purchase Price Adjustments) or an indemnity escrow to provide a remedy if certain obligations are not met.

EV (Enterprise Value): The entire value of a company, including both debt and equity. It is calculated as the company's market capitalization plus debt, minus cash.

Exit: How the business owner will leave the business, when he or she is no longer involved in company operations.

Exits can be planned (such as retirement or transfer of ownership) or unplanned (such as death, disability, management disputes, or unforeseen economic events.)

An exit can also refer to the point in the process when the owner receives the cash in exchange for relinquishing ownership.

Family Office: A privately held company that handles investments and wealth management services for families that have $100 million or more in investable assets. The goal of the family office is to grow and transfer wealth from one generation to the next.

Finder's Fee Agreement (FFA) / Referral Fee Agreement: An agreement to pay an individual with knowledge and contacts in a specific field for making a successful introduction to a qualified buyer or seller.

Indemnity Clause: A contractual provision in which one party agrees to compensate the other for losses, damages, or liabilities that may arise from specific events or circumstances related to the transaction. It helps allocate risk between the parties involved and provides a level of protection against

potential financial or legal risks.

Industry Expert: A person or entity with the specific experience and knowledge required to render an opinion regarding the value of assets held by the target company in an acquisition. The industry expert should not have any prior business or personal relationship with the advisor, or the directors involved in the transaction.

Investment Teaser: A document that announces a company is for sale without identifying the specific company. An M&A Advisor prepares the teaser and circulates it to companies that might be interested in the company for sale.

IOI (Indication of Interest): Also known as a **LOI** (Letter of Intent or Letter of Interest). A letter that officially confirms a buyer's interest in acquiring a company. It provides an "opinion of value" for the acquisition target and outlines the general conditions for completing a deal. Clauses in the letter will require exclusivity and confidentiality.

The letter of intent/indication of interest is *not* the same as the legally binding purchase agreement (contract) to determine the final price and conditions of the sale.

An indication of interest letter simply signals that a potential buyer wants to begin the due diligence process. Many deals fall apart between the time a letter of interest is received and the due diligence process is completed.

Liabilities: Legal responsibilities that haven't yet been paid. This includes debts, interest, or taxes, salaries, and expenses.

LBO (Leveraged Buyout): An acquisition that uses a significant amount of debt to finance the cost of the acquisition. Typically, the assets of the combined companies are used as collateral.

Liquidation: The sale of all of a company's assets.

- **Liquidation Value** is the net amount that can be realized if the business is closed and the equipment, real estate, and other assets are sold.
- **Forced Liquidation Value** is the value at which all assets are sold quickly, such as through an auction.

M&A Auction: A strategy of bringing a company to market by creating a structured sales process that involves getting different buyers to compete in a bidding process for the company. Auctions can be effective when run by a capable advisor, but they are a lot of work for the company that is for sale. Additionally, despite the use of non-disclosure agreements, it is nearly impossible to keep an auction

confidential. This means the seller's employees, customers, vendors, and competitors will know the company is for sale.

Main Street: M&A professionals use this term to refer to businesses that typically sell for less than $5 million.

Middle Market: Companies that have annual (gross) revenues between $5 million and $1 billion. The middle-market companies are divided into three tiers:

- **Lower Middle Market (LMM):** These target companies have annual revenues in the range of $5 million to $50 million.
- **Middle Marke**t companies have revenues in the $50 million to $500 million range.
- **Upper Middle Market** companies have annual revenues from $500 million to $1 billion.

MBI (Management Buy-In): An outside manager or management team obtains the financing needed to acquire a target company with a management void. The managers retain operational control while holding equity.

MBO (Management Buy-Out): A process in which the management of a company acquires all or some of the ownership of the company they manage

Multiple of Earnings: Casually referred to as a "multiple," this is one way to determine the value of a business during a sale. It involves multiplying a company's profits by a certain number to end up with a value. A "multiple" can be based on the earnings for one year or the earnings over a number of years.

NDA (Non-Disclosure Agreement): A legal contract in which the buyer and seller agree that no one involved in the transaction will discuss details of the proposed acquisition or merger with anyone who is not involved. The terms of the agreement will vary. Some NDA agreements prohibit the signatories from contacting company staff members before or after the sale. Others clearly spell out the legal remedies available if one party breaches the agreement. The provisions of this agreement are valid for a specified period of time.

NCND (Non-Circumvention Non-Disclosure) Agreement: When an intermediary brings a buyer and seller together in the early stages of a business transaction, this agreement stipulates that the intermediary who brought the buyer and seller together should not be bypassed. The signers of this document also agree that any information disclosed during negotiations will not be revealed to any external or unauthorized party. This agreement is usually valid for a specific term.

Off Market Deal: A strategy of bringing a company to market that is very focused and confidential. These transactions involve a direct connection between key executives of both parties. These transactions are more focused on and easier to keep confidential.

Platform Acquisition: The initial high-value acquisition a private-equity group makes to enter an industry. The private equity group may use the platform acquisition as a base from which to expand by making subsequent lower-value one-off or roll-up acquisitions. Platform acquisitions typically are leaders within their fields and have strong management teams and well-established processes that can be used to manage multiple locations.

PMI (Post-Merger Integration): This process determines how the acquired company will be integrated with the acquiring company.

- **A horizontal integration** aligns two companies that operate within the same segment on a supply chain.
- **A vertical integration** joins two companies that formerly served different functions in the supply chain (e.g., when a label printing firm is integrated with a converting company).
- **A backward integration** adds a supplier company to a company that uses its supplies. (e.g., when an inkjet printer manufacturer acquires an ink chemistry company or printhead developer).

Portfolio Company: A company that has received an investment from a private equity fund.

Private Equity Group (PEG): An organization that uses a pool of available equity capital to invest in public and private companies.

POF (Proof of Funds): A document proving that a person or a company has the financial ability to perform a transaction. The POF can be issued by a bank, a financial institution, or trade finance market tools. For instance, a POF is generally obligatory for people seeking mortgages because bankers prefer to issue a mortgage to someone with sufficient funds to pay their mortgages off over time.

Purchase Agreement: Legal contract that confirms the negotiated details of the final payment and the mechanics of how the two companies will be consolidated. Experienced M&A lawyers can help business sellers evaluate all of the covenants, conditions, tax implications, and termination provisions included in the purchase agreement.

Purchase Price Adjustments: A component of most purchase agreements that protects the buyer and seller in the event the balance sheet of the acquiring company does not meet the expectations of either party at closing. The mechanics of the adjustments are negotiated and part of the final purchase

agreement.

Retainer Agreement: A contract in which the client pays an advisor in advance for work to be specified later. A recurring retainer fee guarantees that the advisor will reserve time to keep the transaction moving along.

Roll-up: A strategy in which investors acquire and merge multiple small companies in the same market. The primary aim of a roll-up is to reduce operating costs by consolidating redundant sales, production, and administrative functions.

SDE (Seller's Discretionary Earnings): A cash-flow based measure of business earnings in an owner-operated business. It includes the profit (before tax and interest) of a business before subtracting items such as the owner's salary and benefits, non-cash expenses, extraordinary one-time investments, and other non-related business incomes and expenses. This metric gives potential buyers a better picture of their expected return on investment.

Sell-Side M&A Lawyer: An attorney with experience representing business owners during M&A transactions. An experienced M&A attorney helps sellers identify potential legal issues that may arise during the sale and understands how to navigate some of the legal intricacies and emotional issues that arise during the M&A process.

Shopworn: A term private-equity investors use to describe a target business that has lost its appeal. The investors may consider the business overpriced or the seller difficult to work with. Or potential investors might wonder why a business has been on the market for a long time. Investment groups will move on from shopworn companies without making an offer.

SPAC (Special Purpose Acquisition Company): A company formed to raise capital for the purpose of acquiring an existing company. The capital typically comes from either private equity or an Initial Public Offering (IPO).

Strategic Investor: Individuals or companies that invest in a company to gain access to proprietary technology, expertise, or a geographic location that will help the investors acquire strategic advantages instead of just financial returns.

Success Fee: This fee gives the M&A advisor an incentive to help bring the deal to completion. The amount of the success fee depends on the size of the transaction.

Synergy: When the capabilities of the combined companies result in a value that is greater than the sum of its parts. Sharing purchasing power, expertise, and operational capabilities can help the integrated companies achieve returns that might not have been possible if the two companies had continued to operate independently.

Target: The company the buyer wants to acquire.

Takeover: An unfriendly acquisition in which the board of directors of the target company hasn't agreed to the terms of the acquisition. The acquiring company strives to buy enough shares from stockholders to gain control. The board of directors may fend off the takeover with a "poison pill" strategy that allows existing shareholders to buy additional shares at a discount.

Tax Advisor: A financial professional who suggests strategies to legally minimize taxes owed.

Tear Sheet: An overview document that summarizes key information about an individual company or fund.

TTM (Trailing Twelve Month): The last 12 months of a company's financial performance used for financial reporting. The 12 months does not necessarily coincide with the company's fiscal year. TTM is typically used to describe earnings, but can also be used with revenue, cashflow, and financial ratios.

Tuck-in Acquisition: A larger company completely absorbs a smaller company. The smaller company does not maintain any of its original systems or organizational structures after the acquisition.

Valuation: A determination of the current and projected monetary value of a business. Appraisers use different methods to assess the value of a business.

Warm Introduction: When Person A (the M&A advisor) enthusiastically introduces Person B (the business seller) to Person C (the potential investor). A warm introduction is an excellent way to jump-start the M&A process because the M&A advisor vouches for the character and trustworthiness of the seller and already understands the buyer's investment criteria.

Working Capital: A crucial measure of a company's financial health and its ability to meet its short-term financial commitments. Working capital refers to the difference between a company's current assets (such as cash, accounts receivable, and inventory) and its current liabilities (such as accounts payable and short-term debt. It represents the funds a company has available to cover its day-to-day operational expenses and short-term obligations.

Working Capital Adjustment: The most common purchase-price adjustment in an M&A agreement. It is an adjustment to the purchase price based on a negotiated level of working capital to be in the business at the time of the sale. (The adjustment is usually based on historical performance) Additional working capital results in an increase in the purchase price and lower working capital results in a reduction of the purchase price. Cash is generally not included in determining the working capital adjustment.

Disclaimer: *The definitions in this glossary are intended as a basic introduction to the type of verbiage you may hear from M&A advisors and potential investors in your company.*

State governments and federal agencies such as the Security & Exchange Commission (SEC) may frequently update the rules and regulations governing M&A transactions. So, the legal definitions of some of these words may change over time.

To ensure that your business has access to the most up-to-date definitions and guidance, include an attorney experienced in mergers and acquisitions on your M&A advisory team.

Please contact me (rock@rocklamanna.com) if you would like to clarify these terms or suggest additional words or phrases that should be included in this glossary.