



# MERGERS & ACQUISITIONS GLOSSARY OF TERMS

<b>Acid Test Ratio</b>	<p>This is also known as the "Liquidity Ratio". It is a ratio used to assess the liquidity of a company i.e. the current assets less stock to current liabilities. It is shown as a percentage.</p> <p>E.G. a company with liquid assets of assets of £50k including stock of £15k and current liabilities of £20k will have a liquid ratio of <math>50,000 - 15,000 / 20,000 = 1.75</math> or 175%. The company has £1.75 of liquid assets excluding stock for every £1 of current liabilities.</p>
<b>Aged debtor analysis</b>	<p>A breakdown of the length of time the debts of a business have been outstanding. This would usually be expressed as the amount of debt that has been due for less than 30 days, between 30 and 60 days, between 60 and 90 days and longer than 90 days. This assessment is often used for estimating future cash flow requirements and as part of a businesses credit control process.</p>
<b>AIM</b>	<p>Alternative Investment Market. A market of the London Stock Exchange which allows smaller companies to raise capital and have their shares traded in a market without incurring the expense of a full market listing.</p>
<b>Assets</b>	<p>Any object tangible or intangible owned by a company, including items that it is owed. Assets can be described as either "Fixed" or "Current". Fixed assets include land, buildings and machinery. Intangible assets include goodwill. Current assets include cash, investments, money due, materials and stocks.</p>
<b>Asset based finance</b>	<p>Lending that is founded on specific assets i.e. commercial mortgages based on property. This is often a crucial element when financing a buy-out.</p>
<b>Asset cover</b>	<p>This is a ratio used in measuring the solvency of a company. It is calculated by dividing the net assets by the debt.</p>
<b>Bear market</b>	<p>Where a dealer or speculator is more likely to sell than to buy. A "bear" may even sell securities, currencies or goods without having them. This is known as selling short or establishing a bear position. The bear hopes to close (or cover) a short position by buying at a lower price the securities, currencies or goods previously sold. The difference represents the bear's successful profit. A concerted effort to force prices down by one or more bears is known as a bear raid.</p>
<b>BIMBO</b>	<p>This is a combination of a management buy-in (MBI) and a management buy-out (MBO). In a BIMBO, key people such as an investing Chairman, Finance Director or Managing Director are added to an existing management team, perhaps to replace an exiting owner or simply just to strengthen the team. This combination can be ideal in that it provides new, backed, management together with the knowledge of the existing management team.</p>
<b>Book value/net worth</b>	<p>This is the accounting value of the business or an asset according to financial records and statements.</p>
<b>Bull market</b>	<p>Where a dealer or speculator is more likely to be a buyer than a seller even to the extent of buying without having made a corresponding sale thus establishing a bull position.</p>
<b>Business Angel or Informal Investor</b>	<p>A high net worth individual that is willing to provide a company with capital in exchange for a high proportion of shares. Usually, their investment will be below £250,000. Business Angels will often require an exit route and will normally want a say in the way that the business is run.</p>

<b>Business plan</b>	A detailed plan which sets out the objectives of the business over a stated period, often three, five or ten years. For new businesses it is an essential document for raising capital or loans. The plan should include a cash flow analysis, anticipated profit and loss accounts and balance sheets for at least the first two years. The plan must also include the strategy and tactics, which the business intends to use to achieve its objectives.
<b>Buy and Build</b>	Buying a company with a financial and business plan to develop the company significantly in the short and medium term.
<b>Capital</b>	The total sum that an individual has invested in a business or the business net worth.
<b>City Code on Take-overs &amp; Mergers</b>	Representatives from the London Stock Exchange, clearing banks and other financial institutions set down the code which was initially introduced in 1968 and since modified. The code attempts to ensure all shareholders including minority ones are treated equally, are kept advised of the terms of all bids and counter bids. Its many recommendations are aimed at preventing directors acting in their own interest rather than those of the shareholders to ensure that negotiations are conducted openly and honestly.
<b>Collateral</b>	A form of security such as shares offered to secure a loan.
<b>Comfort letter</b>	A letter of reassurance from the parent company of a subsidiary trying to borrow money from a bank. The letter will support the application but not act as a guarantee for the loan.
<b>Completion accounts</b>	These are a set of financial accounts (a balance sheet and a profit and loss account) produced as at the date a business is sold. The completion accounts are produced to show the state of a business at the point of sale. The sale price is often adjusted in accordance with pre-defined formulas applied to the completion accounts.
<b>Confidentiality undertaking</b>	An undertaking provided by a purchasing party to keep all information regarding the business in the strictest confidence. The undertaking is legally binding with recourse. Also known as a non-disclosure agreement (NDA).
<b>Consideration</b>	Proceeds received or receivable on a disposal of an asset. This can be in various forms including cash, shares or loan notes.
<b>Contingent liabilities</b>	An accounting term for a liability that is anticipated if a particular event occurs. In business sales, a typical example of where this term might arise is if a court case is pending at the point of sale. If it is anticipated that the company would lose the case, the potential loss to the company (the "contingent liability") is then calculated. Often in a business sale an indemnity will be asked for from the vendor against potential contingent liabilities.
<b>Data-room</b>	A service made available to both the purchaser and their advisors in order for them to view / inspect company information during the due diligence procedure.
<b>Deadlock</b>	Where parties seek to resolve a conflict or difference but can't see a way. Deadlock will often occur where there is a lack of understanding over each party's requirements.
<b>Deal</b>	When the parties involved in a sale have agreed the price and terms under which the transaction is to be carried out.

<b>Debentures</b>	A long-term loan taken out by a company which is usually repayable by a fixed date. The majority of debentures carry a fixed rate of interest that must be paid before dividends are paid to the shareholders. Most debentures are secured by the borrower's assets, although there are some, referred to as naked debentures or unsecured debentures, which are not secured.
<b>Deferred consideration</b>	An agreement in which payment of the consideration is delayed until a certain date or until a specified event has occurred. Often paid in instalments with interest. A vendor loan is a deferred consideration payment. Security and or personal guarantees will often/should be asked to give collateral for deferred payments. See performance related payment.
<b>Disclosure letter &amp; disclosure bundle</b>	<p>A document which discloses statements of condition, fact and vendors beliefs relating to a business at the time of sale. It forms part of the completion documentation.</p> <p>A disclosure letter serves two purposes. One is to attach a set of all relevant company documentation and the second is to vary the effect of the warranties contained in a Sale and Purchase Agreement.</p>
<b>Discounted cash flow</b>	A method of budgeting that estimates today's value of money to be received in the future; It is discounted due to the uncertainty of its true value in the future and for the cost of the capital (less valuable than the cash in your hand today due to inflation).
<b>Dividend cover</b>	Dividend cover is the number of times that a company's dividends could potentially be paid out of its net profit after tax in the same period (profit after tax divided by the dividends paid). Prudent companies retain a percentage of their earnings. A ratio of 2 or more is generally accepted as comfortable, and anything below 1½ as an alarm bell. If the ratio sinks below 1, the company is paying out more than its earnings and distributing part of its retained surpluses. Circumstances vary – this may or may not be a bad thing in the shorter term. However, it is clearly a situation, which cannot continue indefinitely.
<b>Dividend yield</b>	<p>The dividend yield is one of the key measurements for shareholders. This is the amount of dividend received per share expressed as a percentage of the market price of the share. The dividend may be paid in two instalments: the interim and final dividends. Most dividends are paid after deduction of tax: yields are generally expressed 'gross'. The tax deducted is added back as part of the calculation. A gross yield of 5.5% is equivalent to a net yield of 3.3% to a higher rate taxpayer.</p> <p>How should we interpret the yield?</p> <p>Very high yields may indicate that a company was expected to reduce its dividend pay out. The share price has fallen on the stock market because reduced profits are expected. The calculation uses last year's dividend and this year's (reduced) share price. Last year's dividend is expected to have been higher than this year's. Low yields may indicate expectations both of a growth in profits and of increased dividends and a share price, which has already risen. Shares in different companies may be compared through dividend yields.</p>
<b>Due diligence</b>	Due diligence is the process, prior to completion and acquisition, of verifying the information provided and diligently checking the suitability of the acquisition, the company's history and future prospects. External professional advisors are often used to assist in this process. Due diligence is sometimes broken down into a number of distinct areas; financial, legal, commercial, environmental, cultural, IT etc.

<b>EBITDA</b>	Earnings before interest, tax, depreciation and amortisation.
<b>EBIT</b>	Earnings before interest and tax
<b>Earn out</b>	Where some, or even all, of the purchase price for a business is paid over a period of time. This usually involves a continued involvement from the vendor and may also be a variable sum, linked to certain criteria being met, typically the future financial performance of the business.
<b>EIS</b>	Enterprise Investment Scheme. Tax efficient investment in a company for individuals enabling either income tax relief and/ or reinvestment relief for capital gains tax purposes. There are strict conditions applying to the investor, the investment and the company and prior clearance must be obtained from HMRC. The company equivalent is the corporate venturing scheme.
<b>Elevator deal</b>	A transaction where the purchaser acquires a shareholding greater than 50% and the vendor retains a shareholding. The vendor stays with the business and the new funds, and probably the ideas and infrastructure, provided by the new investor are used to grow the business. The investor has the right to buy the remaining element at a higher 'elevated' price, usually predetermined by a formula.
<b>Equity</b>	The amount by which the value of an asset exceeds any liabilities attached to it.
<b>Equity finance</b>	A form of finance, where equity in the business is provided in return for providing finance.
<b>Escrow</b>	Noun – Law – “a bond, deed, deposit kept by a neutral third party until a specified condition has been fulfilled”.  Origin – old French (legal system has origins in France) – “escroe” meaning “scrap, scroll”. Related to “shred” and, therefore, “shroud”.  Shroud – length of cloth or enveloping garment or a thing that obscures or protective casing concealing from view.  EG: A deed that has been signed but will not become operative until a pre-determined event takes place. Money held in escrow is controlled by a third party (often a lawyer) and is only released to the beneficiaries when a certain event takes place (usually completion).
<b>Factoring</b>	The buying of trade debts of a company assuming the task of debt collection and accepting the credit risk, thus providing the company with working capital. A firm that engages in factoring is therefore called a factor.
<b>Financial assistance</b>	Section 151 of the Companies Act specifies that no company can financially assist in the purchase of its own shares. The act aims to protect any company from exhausting it's own capital base and thus compromising its ability to meet any liabilities to its creditors. (See “whitewash”).
<b>Float</b>	A flotation is the offering of initial shares to the public on a quoted stock market. Will it float or sink. i.e. will the public buy the offering. The process is known as an initial price offering (IPO).

<b>FT-SE</b>	The Financial Times Stock Exchange Share Index is sometimes known as "the Footsie". The Financial Times publishes the FT-SE 100 Share Index, which reflects the combined performance of the 100 largest companies quoted on the UK stock market. The index shows the current level, the highs and lows, and levels at other specified dates. The FT-SE 250 shows the combined performance of the next 250 largest companies below the top 100. The FT Actuaries All Share Index shows the daily performance of the top 800 companies.
<b>Gearing</b>	The level of borrowing (debt) to equity.
<b>Goodwill</b>	<p>Goodwill: a kindly feeling, a well-being, benevolence.</p> <p>What is business goodwill? The advantage or favour a business has in its custom and trade.</p> <p>What is financial goodwill? The excess of the purchase price (not its valuation but what is achieved) over and above the value assigned to its net assets exclusive of goodwill.</p> <p>In other words goodwill is an abstract concept. It also means different things to different people. Therefore it stands to reason that goodwill is a matter of opinion. Some even argue that it does not exist. Goodwill could also be the measure of trust the market has in a business.</p>
<b>Grooming</b>	The process of preparing a business for sale in order to make it more attractive to a potential buyer.
<b>Hand-over</b>	A period in which the selling party 'hands-over' knowledge, contacts, relationships etc. to the purchaser. The complexity of the business being sold, level of involvement in the day to day running of the business the vendor has and skills and industry experience the purchaser has will dictate the length and structure of the hand-over required.
<b>Heads of Terms</b>	A document that outlines the key points of an agreed transaction and which is then used as the basis to prepare the legal contracts. The heads of terms is not usually legally binding save for specific clauses relating to exclusivity and confidentiality.
<b>Hive down</b>	Where the trade and assets of a company are transferred into a subsidiary company.
<b>Hive up</b>	Where the trade and assets of a company are transferred into a parent company.
<b>Indemnities (Warranties and Indemnities)</b>	An indemnity is an undertaking to pay or reimburse in full without declaration against a particular event occurring. It is not subject to any minimum or maximum amount. Often money will be held in an account (see "escrow") against a financial claim being made against a warranty. A warranty is an undertaking or guarantee offered against a potential event. It may be subject to restrictions on the minimum or maximum amount referred to in the sale and purchase agreement.
<b>IPO</b>	Initial Public Offering – also known as flotation.
<b>IRR</b>	Internal rate of return
<b>Know-how</b>	The ideas, procedures, products and personal knowledge of a business normally residing in its people. Unless this is transferred on a sale, goodwill will rapidly dissipate. An experienced buyer will work out a deal that retains know-how, or intellectual capital.

<b>Listing</b>	The flotation of a company on the stock exchange
<b>Loan note</b>	<p>The legal document detailing the terms of 'loan capital'; effectively an IOU issued by a company. Loan capital is capital used to finance an organisation that is subject to interest over the life of the loan, at the end of which the loan is usually repaid (see debenture).</p> <p>In M&amp;A terms, a loan note is issued by a purchasing company to the seller in place of cash. From the purchaser's viewpoint, this assists them in the cash flow requirements of an acquisition. From a seller's position, certain types of loan notes can be tax beneficial, particularly as the taxation is usually crystallised at the time of issue of the loan note, though is not payable until the loan note is realised.</p>
<b>Market capitalisation</b>	This is the value put on the company by the stock market. It represents the cost of buying all the shares in the company at the share price quoted.
<b>MBI (Management Buy-In)</b>	The acquisition of a company by a manager or management team from outside of the company who buy it, and then become the new managers.
<b>MBO (Management Buy-Out)</b>	The acquisition of a company by its existing managers.
<b>Memorandum of Association</b>	An official document setting out a company's existence. It includes the registered office of the company. A statement of the company's objectives (called the objects clause) the amount of authorised share capital and its division.
<b>Merger</b>	<p>A combination of two or more businesses on an equal footing that results in the creation of a new reporting entity. The shareholders of the combining entities mutually share the risks and rewards of the new entity.</p> <p>For publicly quoted companies, mergers must be conducted on lines sanctioned by the "City Code on Take-overs &amp; Mergers".</p>
<b>Mezzanine finance</b>	<p>This is loan finance that is halfway between equity and secured debt. These facilities require either a second charge on the company's assets or are unsecured.</p> <p>As the risk is consequently higher than senior debt, the interest charged by the mezzanine debt provider will be higher than that from the principal lenders and sometimes a modest equity "up-side" will be required through options or warrants. It is generally most appropriate for larger transactions.</p>
<b>Minority shareholder</b>	A shareholder who holds less than 50% of the company's shares is classed as a minority shareholder. They can receive their share of the profits in the form of dividends however they cannot on their own control or determine company policies.
<b>Negotiation</b>	<p>The process of trying to bring together two or more parties in order that an agreement is reached. Generally the aim of negotiation is to obtain a mutually beneficial solution, which involves uniting interests giving both sides a degree of satisfaction to the agreement.</p> <p>Win/Win: Where both sides feel they have obtained a good deal.</p> <p>Win/Lose: Where one side considers that they have a good deal and the other perceives they are hard done by. The deal might still happen but there will be bad feeling that might result in criticism, or lack of support in a hand-over.</p> <p>Lose/Lose: Where ultimately neither side succeeds in their objectives. This might occur when a Win/Lose deal is agreed and one party backs out leaving both with large professional bills.</p>

<b>Net asset value</b>	The value of the assets of the company plus what it is owed minus what it owes. Shown as shareholders funds on a balance sheet.
<b>Net return</b>	This is the true economic view of a company. It is calculated by recasting the financial statements of a business to eliminate direct and indirect owner related expenses as well as extraordinary or non-recurring items. This type of recast is known as an add-back. There might also be the converse, an add-on where the expenses are not realistic with beneficial rents or lower salaries being paid.
<b>Non-Embarrassment Clause</b>	The rights given to a vendor should a successful purchaser re-sell the business within a certain period of time and who benefits from a higher sale value. This usually takes the form of financial compensation.
<b>Partnership</b>	<p>A partnership involves two or more people jointly running a business with a view to making a profit. Although you do not have to formally register a partnership, it is recommended that a Partnership Agreement be drawn up. Included in the agreement should be who has put what into the business, who does what work, how your profits are shared and what would happen if you decided to wind up the partnership.</p> <p>Each partner is personally liable for all debts incurred by the business. Trust in this type of business relationship is therefore crucial.</p>
<b>Payback period</b>	How long it will take to repay the amount invested at current levels of earning.
<b>Phoenix</b>	A buy-out from a liquidator.
<b>Plus Market</b>	An independent market for listing small to medium sized companies.
<b>Price earnings (P/E) ratio</b>	<p>The P/E ratio is the ratio of the price paid per share in a company to the earnings that share produces annually. The P/E ratio is widely quoted as a basis for comparison. There are those who regard P/E ratios as having their uses, even if they are a limited tool. Different types of businesses attract different P/E ratios.</p> <p>For a quoted company, the P/E ratio is calculated as the current quoted share price divided by the year end dividend declared per share.</p> <p>As regards privately owned companies, this is more likely to be the price paid per share divided by the post-tax profit per share. It may be that the shares were purchased a number of years earlier and therefore the P/E ratio may not be so relevant.</p>
<b>Put option</b>	The right to buy or sell a defined number of shares at a pre agreed price at a particular date. This is sometimes used if a purchaser buys a proportion of a business and has a put option to buy more of it at a later date.
<b>Ratchets</b>	A structure whereby the eventual equity allocations between the groups of shareholders depend on either the future performance of the company or the rate of return achieved by the private equity firm. This allows management shareholders to increase their stake if the company performs particularly well.
<b>Restriction of trade (non competition clause)</b>	A clause or series of clauses in a sale contract that prevents the seller from entering into a competitive business or performing competitive activities after the sale of a business. Typically the restrictions will be before a defined period and within a defined geographical area. Unlike employment law where restrictive covenants imposed on employees are often considered unenforceable, they are enforceable in the case of the sale of a business when drafted correctly.

<b>Return on capital employed (ROCE)</b>	An accounting ratio expressing the profit of an organisation as a percentage of the capital employed (the rate of return required on money invested). This should certainly be more than the rate of interest you could get from leaving your money in a building society account. This is the reverse of a P/E ratio.
<b>Sale and Purchase Agreement (SPA)</b>	A legal contract setting out the details and terms of the purchase of a business or business asset. This is typically drawn up by lawyers and includes details of all aspects of the transaction, including details of what is being sold, the price to be paid, any restrictive covenants on both buying and selling parties and warranties and indemnities provided to the purchaser by the seller etc.
<b>Security</b>	An asset or loan to which a lender can have recourse if a borrower defaults on his loan payments. Sometimes referred to as collateral or a charge.
<b>Stamp duty</b>	A duty on documents relating to the purchase or transfer of shares and securities. These must be physically stamped at a Stamp Office and the duty paid to the Revenue.
<b>Sweetheart approach</b>	A 'one' company direct approach. These are quick and easy deals but with no competitive process often leading to lower values.
<b>Target</b>	The chosen company to be acquired.
<b>TUPE – Transfer of Undertakings (Protection of Employment) Regulations 1981</b>	<p>Regulations governing the right of employees to have continuous employment and have their terms of employment honoured and maintained when business activities are transferred from one party to another. This is applicable to both whole businesses and divisions of businesses.</p> <p>One misconception of purchasers, particularly in an asset sale, is that they can leave behind unwanted employees. However, all employees are covered by TUPE and, as a result the business is transferred as a going concern and classified as an 'undertaking', they will automatically become employed by the purchaser.</p> <p>In addition the accrued rights and terms and conditions will pass to the purchaser. As many acquisitions lead to rationalisation of workforce, it is essential that the purchaser quantifies the total contingent liability prior to the transaction and it is made clear that this is his/her responsibility. The purchaser should insist on warranties and indemnities with respect to employee claims and attaching contingent liabilities.</p>
<b>Unique Selling Point (USP)</b>	Something relating to the product or service which a business provides that differentiates it from the competition
<b>Valuation</b>	<p>This is the calculated estimated value of a business. To value a business it is necessary to understand its structure. The type of business, the way in which it is runs and trades effects the calculations that are used in assessing its value.</p> <p>There are four elements that should be considered when determining a value: property, other fixed assets, net current assets and goodwill. Two examples of property are freehold and leasehold, in very broad terms the first has a value the second usually does not. Other fixed assets include such items as fixtures and fittings, plant, equipment and vehicles that should be valued on a second hand resale basis. Net current assets including items such as stock, cash, debtor/creditor balance etc. have a value at cost to the business with old or redundant stock being discounted or written off. Goodwill is the intangible element that has a value reflecting historical trading patterns, future potential and the businesses financial results. To ascertain the value of goodwill a multiplier is often used on both the visible and invisible profits of the business.</p>

**Venture Capitalist (or Private Equity Firm)**

The worth of a business is a combined value of the above. But before the four elements are simply added up a consideration has to be made between the total investment level and profits achieved. If one of the first three elements that make up the price is unusually high, it may have a detrimental effect the goodwill element. This is determined by using a lower multiplier when calculating the goodwill. Once all factors have been considered the business then has a calculated value.

A person or a firm investing funds in a higher than usual risk business venture expecting high financial returns and very often a quick exit route.

**Warranties (Warranties and Indemnities)**

A warranty is an undertaking or guarantee offered against a potential event. It may be subject to restrictions on the minimum or maximum amount referred to in the sale and purchase agreement. An indemnity is an undertaking to pay or reimburse in full without declaration against a particular event occurring. It is not subject to any minimum or maximum amount. Often money will be held in an account (see "escrow") against a financial claim being made against a warranty.

**Whitewash**

See also "Financial Assistance"

Whitewashing is the procedure authorised by the Companies Act in order for a company to assist in the purchase of its own shares. This is only permitted should a company be able to prove that it can pay its debt for a period of 12 months following the assistance being given.

There are strict rules governing the whitewash procedure that must be followed.

**Working capital**

Readily accessible capital available for the day-to-day running of a business. In accounting reports this is calculated as the current assets minus current liabilities.

