

Some useful terms Sellers should know about doing an M & A Deal

There are several terms that Sellers and Buyers of businesses should know. Here are a few:

1. EBITDA – stands for Earnings before Interest Taxes, Depreciation and Amortization and is the key variable that most M & A professionals use to value a company. Essentially EBITDA takes annual earnings of a company and adjusts for non-cash items like depreciation and amortization and financing issues giving rise to interest. Despite many finance purists warning us that EBITDA is a dangerous variable to use to assess a company, it is still very much used. Anytime you use the Multiple of Earnings method to value a business the odds are that you will be using EBITDA as a key metric.
2. “Adjusted” EBITDA – to get at the proper EBITDA number to value a business, EBITDA often has to be “adjusted” for any non-recurring revenue expense items and for non- business expenses put through the company’s income statement. Examples of these adjustments might be a one-time large legal bill for a once in a lifetime lawsuit or personal entertainment expenses of an owner put through the company. The other common adjustment to EBITDA is for the owner’s salary depending on how it compares to what a buyer would have to pay a new manger to do what the owner has been doing. Some owners over pay themselves while others under pay taking money out of the company through dividends.
3. SDE- Seller’s Discretionary Earnings- This term is sometimes used to value very small companies and differs from EBITDA because the owner’s salary and expenses are added back into earnings *with no deduction for what the owner’s replacement might cost*. SDE generally produces a higher earnings number but a lower multiple used to value the company.
4. An EOI versus a LOI- EOI stands for an Expression of Interest. LOI stands for a Letter of Intent. Normally an EOI is given by a seller to express their interest in buying a company but the offer will not go into much detail. EOI ‘s normally come earlier in the sales process – say within the first month- with LOI’s coming later on- in the 2nd month. I would never recommend a Seller go “to bat” with a buyer based simply on an EOI. They don’t have enough important information about the offer.
5. APA versus SPA- APA stands for Asset Purchase Agreement which the final, binding document used to close a deal where just the assets are being sold. Today many alarm account deals are done using an APA. SPA stands for Share Purchase Agreement used where the shares of the company are being sold. SPAs are usually considerably longer and more complex than APA’s.

6. TTM- You see this terms used in regards to the financial statements shown to buyers in a deal. TTM stands Trailing 12 months of financials which most buyers will want to see before arriving at an offer.
7. Running an Auction- When selling a business, most M & A types will effectively run an auction amongst the various buyers to try to maximize the price and terms for their client. Running an auction means just what it says- putting the selling package out to several if not many potential buyers and soliciting bids back in from as many as possible. It is critical here than the buyers know that an auction is being held and that they will be bidding against several others. It helps boost the price.
8. Non-Compete versus a Non Solicit- M & A deals will normally have one or the other of these two clauses in them and sometimes both. In simply terms a Non- Compete is the more all- encompassing clause which a Seller should be careful with unless they are truly about to retire for good. A Non- compete generally prevents the Seller from operating at all in the industry that their business is in for a certain geographical area and for a period of anywhere from 2-5 years. In essence the buyer wants the Seller out of the industry completely for as long as possible. For those not ready to retire, they should try to restrict the Non- Compete in regards to what they can't do, where and for how long. I always suggest Sellers be careful what they sign in a non- compete because what they may change their minds over time over what they want to do and where. The courts have stepped in the case of some non-competes where the buyer tries to restrict an owner or employee from working after a sale in the only industry that they are trained in.

A non-solicit is usually narrower in scope and is usually directed at preventing the Seller from approaching the customers or employees he is currently selling for a period of 2-5 years. As a broker I fully support most non-solicits as it seems only fair that a Seller cannot go back after customers that they have just sold.

9. Non-circumvention period or sometimes called a "Broker's Tail"- Most brokers or M & A professionals will insert a non-circumvention clause into their brokerage agreements with their clients preventing the client from cancelling the agreement, then selling the company to a buyer that the broker found and not paying the broker. Typically non-circumvention period are set at 2 years. This means that the broker will still get paid if a business is sold to someone that the broker negotiated with while the agreement was active and within 2 years of the brokerage agreement being terminated. I personally set my "tail "at 12 to 18 months in most of my agreements.
10. Vendor Take Back (VTB) – a VTB is a finance terms describing the fact that a Seller has been willing to forgo getting paid all of his purchase price up front and will take a "note" for part of the purchase price. VTB generally range in size from 15 to 30% of the total purchase price and often attract some interest and are paid out over 2 to 4 years. VTB's are used by the Seller to help close the gap between what a buyer and seller think the company is worth or to help close a deal where the Seller knows the buyer cannot come up with 100% of the purchase price and the buyer's bank will not cover all the difference. Agreeing to a VCTB usually indicates the Seller has confidence in and trusts the buyer.

It helps to know some of the standard M & A terms if you are a Seller. These are just some. More to come.

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