G2G ADVISORY

LBO MECHANICS REFERENCE

EV-Equity Bridge · Completion Mechanisms · W&I · Advisor Fees · Funds Flow · Playbook Tricks

Hyper-Technical Cram Sheet for Live Deals | g2gadvisory.co.uk

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SECTION I: THE EV-EQUITY BRIDGE — THE CENTRAL IDENTITY

Master Equation: EV − Financial Debt + Cash − Debt-Like Items + Cash-Like Items ± Working Capital vs. Target (peg) − Minorities + Investments in Associates + Ticker − Leakage − Seller Transaction Costs = **Equity Purchase Price**. Every single line is negotiated line-by-line. Every single line is worth millions. The buyer wants a low equity price; the seller wants a high one; the bridge is the battleground. The spread between buyer-opening and seller-opening bridges on a £1bn deal is routinely £50–150m. EV is the economic value of the operating engine (capital-structure agnostic, comparable across peers). Equity is what the seller's wire receives on closing. The SPA 'cash-free, debt-free, normalised working capital' wording is mandatory — without it the seller can keep cash, leave debt, and drain working capital. Every offer letter, NBO, binding bid, and SPA must repeat the magic phrase.

Why EV At All: Buyers bid EV because it prices the operating engine independent of the seller's historical capital structure. The buyer is going to refinance on day one — stuffing in their own leverage — so prior debt is irrelevant to asset value. EV/EBITDA and EV/Revenue are the only comparable multiples across peers because equity multiples are contaminated by leverage. Associates who quote 'I bid £1bn' without specifying 'EV basis, cash-free debt-free, normalised WC' will discover at SPA drafting the seller interpreted it as an equity number. Hundreds of millions evaporate in ambiguity. SPA headers, NBOs, and process letters must carry the magic phrase or the bridge has no anchor.

Financial Debt Sub-Components — Every Line Contested:

Bank Debt & Facilities Drawn: Term loans at redemption value (not amortised-cost book value). Revolving credit facility (RCF) drawn — never committed-but-undrawn. Bilateral loans, overdrafts, working capital lines. Always include **accrued interest to the reference date**: on £400m at 8% quarterly, £8m of accrued interest is unmissable material. Seller will want to book debt at carrying value (net of unamortised issue costs); buyer insists on cash-out value (redemption + break).

Bonds & Notes: Book at redemption value, not accounting book value. High yield bonds with make-whole call premiums or non-call periods trigger substantial break costs on refinancing. A 10% coupon bond in its non-call period can trade at 115 — you pay that to redeem, not par. IFRS carrying value is irrelevant. For bonds past their first call date, use the call schedule price (typically par + half the coupon declining to par).

Break Costs & Prepayment Penalties: Debt repaid at closing carries break fees — typically 1% in year 1, 0.5% in year 2 for TLBs, make-whole for high yield. Quantum on a large deal can be £20–100m. Seller tries to push these below the line ('buyer's refinancing cost'); buyer insists they are debt-like ('we wouldn't have to pay them if the seller had left the debt in place'). Market answer: split — genuine break fees triggered *by the deal* go in the bridge; fees for voluntary refinancing of still-performing debt do not.

Finance Leases (IFRS 16): Post-2019 nightmare. Under IFRS 16, *all* leases sit on balance sheet as debt with a matching right-of-use asset. Is a 15-year property lease really 'financial debt' for bridge purposes or is it operating? Answer: debt if it behaves like borrowing (long-term, fixed, site-critical); operating if it is a short-term flexible lease. Most SPAs now define 'Financial Indebtedness' explicitly to sidestep the fight. Billions of pounds hinge on the definition. On a retail chain with £1.1bn of lease liabilities, a 100% inclusion versus 0% inclusion is a £1.1bn swing on the equity price — and this fight alone was central to several 2022–2024 retail take-privates.

Derivatives Mark-to-Market: Out-of-the-money interest rate swaps, cross-currency swaps, FX forwards, commodity hedges — if closing them out costs cash, they are debt. In-the-money positions become cash-like items for the seller. The MTM statement from the counterparty bank on closing date is the arbiter (fixed at a specific 'Valuation Date' and time in the SPA). A portfolio of hedges can move ±£20m between signing and closing on large deals as rates move.

Cash — Not All Cash Is Equal:

Trapped Cash: Cash in subsidiaries where repatriation triggers withholding tax (China, India, Nigeria, Argentina), capital controls, or minority consent requirements. Buyer argues this is not usable cash → exclude or apply a repatriation-cost haircut (e.g. 10% WHT → credit 90% of the nominal).

Restricted Cash: Customer deposits, L/C collateral, regulatory capital (FCA capital requirements, solvency margins for insurance/banks, cash held for payment institution safeguarding). Not cash at all — it is third-party money sitting in a company account. Zero credit in the bridge.

Operational / Float / Cage Cash: Cash the business structurally needs to operate — retail tills, casino cages, ATM float, merchant acquirer settlement balances, airline ticket float. Typically 0.5–2% of revenue. Buyer argues this is working capital (part of the peg), not free cash. Sellers resist. Usual compromise: a 'minimum cash requirement' of £X at closing, above which cash is free.

Overdrafts & Net Cash: £100 cash in one account and £80 overdraft in another — is cash £100 or £20? SPA must define gross vs. net. Most deals use net cash but the overdraft must be captured as debt and not double-counted.

Debt-Like Items — Where Deals Are Won or Lost:

Principle: if the seller could have extinguished an item with cash before sale, the buyer is entitled to deduct it. This list is the single most contentious box in the bridge.

Tax Liabilities: Corporation tax payable to reference date (pro-rated from last balance sheet), deferred M&A consideration, uncertain tax positions (UTPs), transfer-pricing reserves, VAT liabilities. Buyer takes gross; seller argues only 'probable' amounts (IAS 37 / IFRIC 23). Gap typically £10–100m and resolved either via bridge line or specific indemnity outside the bridge.

Pension Deficits: Defined benefit scheme shortfalls — the second-biggest bridge line after debt itself on UK deals. IAS 19 (accounting deficit) vs technical provisions (trustee funding deficit) vs Section 75 buy-out cost — three different numbers, often a 50–100% gap between them. Buyers push for the highest; sellers for the lowest. TPR clearance is a gating item on large UK DB schemes (Morrisons, Boots, Debenhams). Pension deficit typically tax-effected in sophisticated bridges: £50m gross × (1 – 25% CT) = £37.5m net.

Restructuring Provisions: Redundancy, site closure, onerous contracts. If announced and committed before signing → debt-like. If still a management plan → buyer absorbs organically. Board-approval timing matters — a provision booked at the February board meeting lands in the bridge; a plan not yet approved does not.

Deferred Consideration on Prior M&A: Amounts owed by the target from historical acquisitions ('we bought SubCo in 2023 and still owe £30m in 2025'). Contractual future outflows → always debt-like.

Deal & Retention Bonuses: Bonus pool earned to closing. Ordinary-course bonuses sit in working capital. Deal-specific bonuses (retention, transaction, phantom equity, MIP acceleration) are *always* debt-like — they are a cost of the deal itself.

Unfunded Capex Commitments: Signed POs not yet paid for committed capex. Usually operational unless it is 'catch-up capex' the seller should have spent — in which case the buyer argues for deduction.

Litigation Provisions: Material lawsuits with probable outflow. W&I generally excludes known litigation, so the buyer pushes for it as a debt-like item up to expected loss. Disclosed disputes go in, unreported contingents stay out.

Dilapidations: Property lease end-of-term restoration obligations. Long-tail, contractual → debt-like in most definitions. Quantum = PV of expected restoration cost across the lease portfolio.

Customer Prepayments / Advance Revenue: Cash received for services not yet delivered (SaaS annual billings, construction milestone payments, SaaS ARR with multi-year prepay). Buyer argues debt-like because they represent a liability to deliver service for no cash. Seller argues working capital. Can shift £50–500m on software deals. Usual compromise: the amount inside a normal monthly billing cycle stays in WC; anything beyond (e.g. 12-month prepays) is debt-like.

Cash-Like Items — The Seller's Countermove:

Tax receivables & refunds (overpaid CT, R&D tax credits, VAT recoverable — discounted for timing/realisation). Insurance recoveries (documented, probable). Deferred consideration *receivable* from prior disposals (present-valued at credit-adjusted rate). Fixed asset sales already signed but not yet closed. Overfunded pension schemes (rare post-2022 rate rises, now increasingly real — seller wants credit, buyer says surplus is trapped in the trust and not distributable). Asymmetry warning: the cash-like list is almost always smaller than the debt-like list because the buyer writes the SPA first draft and runs DD. Seller advisor must be proactive in vendor DD or cash-like items simply do not appear.

Working Capital Peg — The Normalisation Fight:

Principle: the buyer assumes the business is delivered with a 'normal' level of working capital. Actual WC at closing vs peg → adjustment one-for-one. Actual > peg → seller gets credit; actual < peg → buyer deducts.

Peg Methodologies: Trailing 12-month average (T12M) — most common, smooths through seasonality, simple to compute; trailing 24 months — used for seasonal or high-growth businesses, smoother but can understate current WC need; point-in-time adjusted — same month last year, adjusted for YoY growth; WC % of revenue — best for fast-growing businesses (the peg scales with today's revenue, fair in a growth story).

Stuffed Pegs: watch for sellers excluding a line (unpaid deal bonuses, certain accruals) from both the peg and the closing WC number. Net zero on the bridge but shifts the argument to debt-like items where the seller hopes it dies. Always check peg and closing WC are on *identical line-item definitions*. Peg definitions should be drafted line by line in a schedule, not by a general formula.

How Sellers Game WC Between Signing and Closing: (1) Accelerated receivables collection — offer 2% early-pay discounts, AR drops £40m, cash rises £39m, net benefit £39m to the seller because cash is added 1-for-1 while WC shortfall is capped by tolerance. (2) Stretched payables — delay paying suppliers from 45 to 75 days, AP rises, WC drops, cash rises. (3) Inventory run-down — stop buying raw materials, inventory drops, cash rises; buyer gets a starved factory on day one. (4) Pre-billing customers. (5) Capex deferral — skip two months, cash rises £15m; buyer counters with 'catch-up capex' as debt-like. Buyer defence: strict ordinary-course covenants specifying payment terms, discount policies, capex schedules, and a 'locked box anti-avoidance' clause that treats deliberate WC manipulation as leakage.

Minorities & Associates:

NCI at Fair Value, Not Book: EV is consolidated (captures 100% of a 70%-owned sub). The equity bridge must deduct the minority at **fair value** (i.e. 30% × sub's EV), not IFRS book NCI. Book NCI is the residual of acquisition accounting and is meaningless for transaction pricing. Drag-along rights: if the SPA drags the minority, the buyer acquires 100% directly but the purchase price is funded through EV.

Investments in Associates: sub-50% stakes equity-accounted. They do *not* feed EBITDA (they contribute via share of profits below EBITDA), so they are not captured by EV/EBITDA. Added to EV at fair value on top — a common bridge line that juniors miss.

Put/Call Options on Minorities: if the minority has a put option (can force the group to buy them out), the present value of the put strike is debt-like. Very common in PE rollups where founders retain 10–20% with a 3-year put.

Tax in the Bridge — Four Distinct Layers:

(1) **Current tax payable** — debt-like, pro-rated from last BS (if closing 4 months into fiscal year, 4/12 of full-year provision). (2) **Current tax receivable** — cash-like mirror. (3) **Uncertain tax positions** — debt-like, negotiated. Seller applies IFRIC 23 probability-weighted (typically 50%); buyer insists on gross. Gap of £10–100m resolved via specific indemnity outside the bridge. (4) **Deferred tax assets & liabilities** — usually ignored in the bridge, repriced in buyer's own modelling. Exception: large DTLs on acquired intangibles in asset deals can be treated as cash-like. **Tax structuring above the bridge:** if the buyer can step up the asset base (338(h)(10), French TUP, Brazil goodwill), the resulting tax shield is worth 5–10% of EV and the buyer will pay for it via a higher headline — a pre-bridge decision that changes what EV the buyer is willing to bid.

Ticker (Interest on Equity Price) — The Locked-Box Time-Value Line:

Definition: the ticker compensates the seller for time value of money between the locked-box reference date and actual closing. In a locked box the business is economically run 'for the buyer' from the reference date; the buyer pays only on closing (3–9 months later). Without a ticker the seller has effectively lent the business interest-free. The ticker is the interest on that loan.

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Ticker = Equity Price × Daily Rate × Days from Locked-Box Date to Closing
Typical rate: 4.0%-8.0% per annum, simple interest, paid by Buyer to Seller.
Worked example: £1bn equity price, 120 days gap, 6% p.a. simple → 1,000 × 6% × 120/365 = £19.7m
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Setting the Rate: seller wants high (closer to business return on capital, 10–12%); buyer wants low (closer to cost of debt, 5–6%). Market practice: 4–8% annualised. Either a flat rate or spread over risk-free (SOFR/SONIA + 300–500 bps). Auction process letters now specify the rate up front so bids are comparable — without that, '£1bn with 3% ticker' is materially worse than '£980m with 8% ticker' on a 6-month gap.

Ticker Mechanics: ticker runs on the *final* equity price (post-leakage, post-bridge). It starts at the locked-box date (last audited year-end, typically 31 Dec or 31 Mar), not signing, not closing. It stops at the day before closing or on closing day (negotiated). Long-stop caps: if closing is delayed beyond 9 months (regulatory hold-up), buyers often want the ticker to cap or even flip off. Sellers resist — why should the seller lose the accrual if the delay is caused by buyer antitrust? Simple interest is market — no compounding for sub-12-month gaps.

Ticker in Completion Accounts Deals: there is no ticker in completion accounts — the economic transfer happens at closing. Mixing locked-box and completion-accounts concepts is a rookie error.

Worked Example: £2.5bn equity price, locked box at 31 Dec, signing 15 Mar, closing 15 Sep. Ticker at 6% simple. Days from 1 Jan to 14 Sep = 257. Ticker = 2,500 × 6% × 257/365 = £105.6m. Serious money. Worth the full attention of tax, legal, and an associate running the spreadsheet daily.

Leakage — The Seller's Trust Tax:

Definition: in locked box, the buyer owns the economics from the locked-box date. Any value that 'leaks out' of the target to the seller or its affiliates between locked-box and closing is leakage, and comes off the equity price one-for-one. Items: dividends declared or paid; share buybacks; management fees or monitoring fees to the sponsor; repayment of shareholder loans; waivers of intra-group receivables; transfer of assets below fair value; bonuses paid outside the normal programme; any payment to 'Connected Persons' outside the ordinary course.

Permitted Leakage: a scheduled list of payments the buyer has pre-accepted — ordinary-course salaries, contractual bonuses for non-selling staff, pension contributions, agreed management fees at capped levels, agreed tax distributions. Itemised on a schedule with *specific* amounts, dates, and recipients. No open-ended 'ordinary course' language — sellers drive trucks through it.

Leakage Indemnity: unlike SPA warranties (capped, time-limited, scrubbed by W&I), the leakage indemnity is a **pound-for-pound direct claim** from buyer to seller, with a 6–12 month short-form limitation. No de minimis (occasionally a £50k per-item / £500k aggregate bucket is negotiated), no basket, no insurance between them.

Common Leakage Traps: sponsor monitoring fee invoiced in January after a 31 Dec locked box; retention bonuses board-approved in February; pre-closing property distribution to seller; intra-group debt waivers; unapproved discretionary bonuses; stock-based compensation acceleration. All litigated regularly.

Worked Example — £1.25bn Locked-Box Deal (Full Bridge):

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Enterprise Value (10.0x £125m LTM EBITDA)         1,250.0
  − Financial debt (TLB at par + RCF drawn)     (420.0)
  − Make-whole premium on TLB                     (8.5)
  + Cash & cash equivalents                          85.0
  − Operating cash held back (minimum)          (15.0)
  − UK pension deficit (IAS 19)                     (32.0)
  − Deal & retention bonuses (debt-like)       (11.5)
  − Corporation tax accrued                            (9.0)
  − Restructuring provision committed             (6.0)
  + R&D tax credit receivable                         4.5
  − WC shortfall vs T12M peg                           (3.0)
  − 25% minority in JV at fair value              (42.0)
  + 30% stake in Associate at fair value      28.0
  − Permitted leakage (monitoring fees)        (2.5)
  − Non-permitted leakage (tuck-out)              (0.8)
  + Ticker: 817.2 × 6% × 191/365          25.6
  = Equity Purchase Price                                842.8
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From a headline of £1,250m, the seller receives £842.8m — a third of EV is eaten by the bridge. A 6% vs 4% ticker is £8.5m. IAS 19 vs technical provisions on the pension can be £15m. £15m vs £25m operating cash hold-back is £10m. Every line is £5–50m of argument.

Who Owns Each Line — The Workstream Map:

Bankers (M&A): headline EV, WC peg, ticker rate, operating cash hold-back, overall bridge architecture. **Accountants (Transaction Services):** debt-like / cash-like list from QoE, normalised EBITDA adjustments, WC peg mechanics, debt & net debt schedule — they are the referees on bucket allocation. **Tax Advisors:** tax lines (current, deferred, UTP), transfer pricing, withholding, tax structuring above the bridge (step-up, NOLs, group relief). **Lawyers (Corporate):** SPA definitions of Financial Indebtedness, Cash, Working Capital, Leakage, Permitted Leakage, Ordinary Course covenants, dispute mechanism. **Actuaries (Pensions):** pension number — IAS 19 vs technical provisions vs Section 75 buy-out. On UK deals the pension is often the second-biggest line after debt itself. **Senior MDs:** own the top-level horse-trades — 'we give £15m on the pension to save £15m on the ticker.'

Running the Bridge — Process Timeline:

Week –**8:** first draft — buy-side bankers, accountants, lawyers build the opening position based on VDD, data room, initial QoE. Goes into indicative bid. **Week** –**5:** mark-up exchange — seller comments on every line (accept / reject / alternative). Three iterations before a call parks disputed items. **Week** –**3:** all-hands bridge call — both sides, line by line, 6–8 hours. Disputed items parked for principal-level discussion. **Week** –**2:** principals only — lead MDs/partners horse-trade across unrelated lines. **Week** –**1:** final lock — every line agreed, every number sourced, pasted into SPA as a schedule. **Post-signing:** if completion accounts, another round 60–120 days post-closing; if locked box, only leakage remains open.

The Ten Classic Bridge Errors:

(1) Double-counting IFRS 16 — subtracting lease liability as debt while using post-IFRS-16 EBITDA. (2) Using book debt instead of redemption value. (3) Forgetting accrued interest on debt to reference date. (4) Netting debt-like and cash-like across entities with different tax lives. (5) Ignoring WHT impact on trapped-cash repatriation. (6) Forgetting the pension tax offset (£50m gross × 25% CT = £37.5m net). (7) Wrong EBITDA base for the multiple (run-rate vs LTM, inclusive vs exclusive of IFRS 16). (8) Confusing the peg with prior-period WC. (9) Wrong ticker base — on EV or pre-adjustment price rather than final equity. (10) Using book value for minorities instead of fair value.

IFRS 16 & the Leverage Illusion:

Post-2019, *all* leases sit on balance sheet. Pre-IFRS-16 EBITDA = after lease expense. Post-IFRS-16 EBITDA = before lease depreciation (which replaces lease expense) and before lease interest. The post-IFRS-16 number is 5–10% higher for asset-heavy businesses (retailers, airlines, hospitality). The **bridge choice:** option A — bid '10x post-IFRS-16' and do *not* deduct lease liability; option B — bid '10x pre-IFRS-16' and *do* deduct lease liability. Both arrive at the same equity value if done consistently. The error is to mix them. Most leveraged credit docs now have dual definitions: Net Leverage (excl. IFRS 16) and IFRS Net Leverage (incl.). Sellers quote IFRS leverage at entry ('we are at 3.2x'), buyers recalculate at 5.0x including leases. On a large retail chain sale, the seller presented 8x LTM EBITDA = £2.4bn on post-IFRS-16 EBITDA; the buyer deducted £1.1bn of lease liabilities without recalculating EBITDA → £600m of spurious price reduction until caught at the bridge call and re-anchored on pre-IFRS-16 numbers. Six hundred million pounds of value in a single definition.

SECTION II: COMPLETION MECHANISMS — LOCKED BOX vs COMPLETION ACCOUNTS

Core Choice: locked box (price fixed at signing on pre-signing balance sheet, buyer takes economic risk from reference date, ticker compensates seller, leakage indemnity protects buyer, no post-closing true-up) vs completion accounts (estimated closing statement at closing, actual completion accounts post-closing, true-up payment, no ticker, no leakage). European/UK default = locked box. US default = completion accounts but locked box has spread through sponsor auctions since 2015.

Locked Box — Anatomy:

Reference Date: last audited year-end (31 Dec / 31 Mar) — buyer wants an auditor behind the numbers. Occasionally a more recent interim if deal drags. **Diligence Burden:** QoE validates every bridge line as at reference date. Cash drift between reference date and signing is captured as leakage or permitted leakage. **Benefits for Buyer:** price certainty, no post-closing surprise, no litigation risk, ability to bid confidently with known headline price. **Benefits for Seller:** clean exit — cheque hits on closing, immediate LP distribution, no hangover. PE sponsors strongly prefer. **Risks:** buyer risks business deterioration in interim period (protected by ordinary-course covenants + rare MAC). Seller risks missing upside if business accelerates (protected only by the ticker).

Completion Accounts — Anatomy:

Step 1: Estimated closing statement delivered ~5 business days before closing, estimated equity price, buyer pays the estimate at closing. **Step 2:** Draft completion accounts prepared within 60–90 days post-closing by whichever party controls (often seller, sometimes buyer). **Step 3:** Counterparty review within 30–60 days, objections notified, unobjected items deemed agreed. **Step 4:** Dispute resolution — good-faith negotiation first, then Expert (not arbitrator) appointed, binding final determination, 30 days typical. **Accounting Principles Hierarchy:** (1) Specific Accounting Policies (SPA schedule), (2) Consistent Past Practice, (3) IFRS/local GAAP. This hierarchy decides 90% of disputes. Layers 1–2 negotiated ruthlessly.

Permitted Leakage Schedule — Draft Line by Line:

Ordinary-course employee compensation at prior rates (no acceleration); board fees at contracted levels; sponsor monitoring fees within agreed cap; ordinary-course tax payments; trade payments to connected suppliers at arm's length within defined cap; pre-agreed dividends with specific amounts/dates/recipients; transaction expenses up to a capped amount listed on Schedule X. **Drafting trap:** never use 'any payment in the ordinary course consistent with past practice' — sellers drive trucks through it. Itemise specifically: amount (or formula), timing, recipient.

Expert Determination Process:

Expert ≠ Arbitrator: Expert is a creature of contract (not statute). Often Big 4 forensic accounting partner. Typically no formal procedure, no reasons required, decision **final and binding**, set aside only for manifest error or procedural failure. No appeal. Arbitration by contrast allows evidence, reasoned awards, limited court review. **Appointment:** by agreement, or by President of ICAEW/similar institution if no agreement. **Scope Limitation:** only the accounting line items in dispute — cannot rewrite commercial bargain, cannot reopen agreed items, cannot decide legal questions. **Costs:** almost always 50/50 (each side bears own advisor costs + half Expert fee). **Timing:** 30–60 days, much faster than arbitration (6–12 months) or litigation (2–4 years). Speed is the key advantage.

Interim Period Covenants — The Quiet Battle:

Ordinary Course Covenant: 'operate the business in the ordinary course consistent with past practice.' COVID-19 generated hundreds of disputes — was pandemic response 'ordinary'? **Consent Matters:** list of actions requiring buyer's prior consent — material contracts signed/terminated, capex above £X, headcount reductions, dividends, settlements, M&A, debt issuance, accounting policy changes, tax elections, IP transfers. Typically 20–40 line items. **Information Rights:** monthly management accounts, access to books, CFO, board attendance — limited by gun-jumping rules in antitrust-sensitive deals. **MAC Clause:** material adverse change, the nuclear option. Courts require *durationally significant* impact on *long-term earning power*. Only Akorn v Fresenius (2018, Delaware) has succeeded. COVID-era MAC claims all failed. **Specific Performance:** most SPAs let seller force buyer to close, not just sue for damages — prevents walk-aways.

Conditions Precedent & the Walk Path:

Regulatory approvals: antitrust (EC, DOJ, CMA, local regulators), FDI filings (US CFIUS, UK NSI, EU FDI), sector-specific (FCA, Ofcom, defence national-security). Each adds 60–180 days. Third-party consents: change-of-control clauses in customer contracts, supply agreements, licences, leases, debt covenants. Bring-down of reps: warranties must still be true at closing (subject to MAC standard). No-MAC condition: nearly impossible to invoke. Long-stop date: if CPs not met by X months, either party can walk — negotiated tightly, often driven by lender commitment horizons.

SECTION III: WARRANTY & INDEMNITY INSURANCE

What It Is: insurance policy covering breaches of the seller's warranties and tax indemnities in an SPA. Market standard in European sponsor M&A, spreading in US. Insurer is typically AIG, Tokio Marine, Liberty, Chubb, Beazley. **Seller Dream:** clean exit, no residual liability, sponsor distributes to LPs on closing day. **Buyer Comfort:** an A-rated insurer backs the reps rather than chasing a defunct sponsor through its LPs. **Why It Exists:** auction dynamics — any bidder requiring £100m escrow loses to a bidder accepting W&I. **Market Size:** ~$15–20bn of limits written in 2024. Pricing compressed from 1.5–2% rate-on-line to 0.8–1.2% since 2020.

Policy Mechanics:

Insured: buyer (buy-side policy). **Limits:** 10–20% of EV typically. On £1bn deal → £150m limit in a tower of 1 primary + 3–4 excess layers. **Retention (Deductible):** first 0.5–1.0% of EV (£5–10m on £1bn deal). Ensures skin in the game. **De Minimis:** £50–250k per individual claim, ignored entirely. **Survival Periods:** general warranties 18–24 months; tax 5–7 years; fundamental (title, authority) 7–10 years. **Premium:** single premium at closing, 0.8–1.5% of policy limit. On £150m limit → £1.2–2.2m + taxes + broker fees. **Who Pays:** 50/50 split most common, sometimes buyer pays all (built into bid), sometimes seller pays all (for clean-seller positioning).

Exclusions — What Is NOT Covered (Read This Twice):

Known Issues: anything in data room, disclosure letter, or QoE is known and excluded. Insurer won't pay for anything the buyer knew. Overly fulsome disclosure reduces cover. **Specific Indemnities & Identified Risks:** items covered by specific SPA indemnity (tax disputes, environmental, pensions) are excluded from W&I — ring-fenced via escrow, reduction in price, or direct indemnity. **Forward-Looking & Projections:** business plans, forecasts, pipeline statements — excluded. Policies cover historical facts only. **Criminal Fines & Penalties:** always excluded. **Transfer Pricing Historic Positions:** almost always excluded on cross-border targets. **Bribery, Fraud, Money Laundering:** always excluded. **Product Liability:** mass claims, class actions often excluded or sub-limited (pharma, medtech, auto).

Placement Process:

Broker selection (Marsh, Howden, Aon, WTW — commission from insurer, free to insured). **NBI:** non-binding indications from 5–8 insurers, 3–5 days. **Insurer Selection:** best price + cover, exclusivity granted. **Underwriting Call:** insurer grills buyer's DD team on each workstream (legal, tax, commercial, financial, IT, HR) for 2–4 hours. Weak DD → bigger exclusions. **Final Terms & Warranty Spreadsheet:** column-by-column policy mark-up — each warranty labelled Covered / Partial / Excluded. **Binding:** policy bound on SPA signing, premium paid at closing, policy goes live at closing.

Stapled, Flip, Synthetic & Title Insurance:

Stapled W&I: seller runs the process pre-auction and staples a term sheet to the bid package. Speeds things up, locks in seller-friendly terms (tighter definitions, lower retention). **Seller-to-Buyer Flip:** policy starts with seller as insured, flips to buyer on selection. Seller controls insurer but buyer holds ultimate claim. **Synthetic W&I:** for distressed/pre-pack/sovereign deals where seller refuses any warranties — insurer writes warranties itself referencing the SPA. No seller to chase. 2–3x vanilla pricing because no warranty collateral. **Title Insurance:** real-estate-heavy deals get a separate title policy covering title defects. **Tax Opinion Insurance:** covers a specific tax position (e.g. transfer pricing opinion). Rapidly growing since 2020.

Claims Reality:

~15–20% of policies experience at least one notified claim. ~50% of those pay something. **Typical claim mix:** tax warranties ~25%, financial statements ~20%, material contracts ~15%, IP ~10%, environmental ~10%. **Claim size:** power-law distribution — most small, a few large. **Process:** notify within 30 days of discovering breach, insurer appoints lawyers, negotiation, sometimes litigation. Insurers defend claims like any P&C carrier — they are not pushovers. **Sponsor Wisdom:** 'we price our bids assuming W&I pays nothing.' The policy is a back-stop; your primary protection is still the SPA, disclosure letter, and DD quality.

SECTION IV: ADVISOR FEES — THE FULL ECOSYSTEM

Total Cost of a £1bn Deal: £30–50m across workstreams. **Sell-side M&A:** 0.8–1.5% at top sponsor market, tapering to 0.5–0.8% for larger deals. £8–12m on a £1bn sell-side. Typically success fee only (no retainer on sponsor deals). **Buy-side M&A:** 0.3–0.6% of EV. Often with £100–300k retainer credited against success fee. **Legal (Corporate):** £3–8m, partners £1,200–1,800/hr, associates £400–800/hr. Time & materials capped at agreed maximum. **Big 4 TS:** QoE £0.5–1.5m, tax DD £0.3–0.8m, fixed-fee per workstream with scope overruns billed hourly. **Commercial DD:** £0.5–2m for a Bain/BCG/McKinsey/OC&C/LEK report. Fast 4–6 week engagements. **Environmental DD:** £100–400k. **Debt arranger:** 1.5–3.0% of underwritten debt. On £500m → £7.5–15m. Biggest single bucket on an LBO.

Sell-Side Fee Structures:

Flat Percentage of EV: simplest. **Tiered / Laddered:** higher % above a threshold — e.g. 0.5% on first £800m + 2% above. Incentivises the banker to push price past the threshold. Common on sponsor sell-sides. **Lehman Formula (Legacy):** 5%/4%/3%/2%/1% on each successive $1m. 1960s origin. Rare above $50m but still referenced. **Modified / Double Lehman:** 10%/8%/6%/4%/2% — floating around lower-middle-market. **Incentive Fee on Upside:** 'base fee £X + Y% of any price above £Z.' Cleanest way to align banker with seller reach price. **Retainer & WIP:** £50–200k monthly on strategic deals, rare on sponsor deals, credited against success fee.

Tail, Abort, Exclusivity, Expense Cap, Indemnity:

Tail Period: after termination, banker earns fee if client transacts with any name on 'tail list' within 12–24 months. Without a tail, a client can fire the banker on signing and keep the fee. **Tail List:** delivered at termination — every buyer the banker introduced. Negotiating it is painful. **Abort Fee:** reduced fee (£500k–2m) if deal aborts after significant work. Common on strategic, rare on sponsor ('no deal, no fee'). **Exclusivity:** 12–24 months on the specific asset. Breach triggers fee obligation. Sellers resist, bankers insist. **Expense Cap:** banker expenses billed at cost subject to cap (£250–500k). Above → client approval. **Indemnification:** client indemnifies banker for third-party claims arising from engagement (except gross negligence/fraud). Standard.

Debt Arranger Fees — Biggest Bucket on an LBO:

Underwriting Fee: 1.5–3.0% of committed debt, paid by borrower. On £500m → £7.5–15m. Compensates banks for taking syndication risk. **Arrangement / Structuring Fee:** portion of underwriting labelled structuring, 50–75 bps to the MLA. **Original Issue Discount (OID):** loan priced at 99 not 100 — 1 point of effective extra compensation, common on TLBs sold into CLO markets. Not a fee per se but cash the borrower doesn't receive. **Commitment Fee:** 25–50 bps p.a. on undrawn RCF capacity. **Agency Fee:** £75–300k p.a. to the administrative agent bank. **Market Flex:** underwriting banks can flex pricing up (margin, OID) or structure (add lien, reduce size) if market won't absorb. Negotiated tightly — usually capped at +100–150 bps margin + 100 bps OID. Flex is the banks' escape hatch.

Fee Politics & Playbook:

Repeat Business Discount: sponsors doing 3–5 deals a year get 10–20% off headline. **Relationship Fee Pool:** large sponsors allocate $10–30m/year of 'relationship fees' to banks even on deals where the bank didn't work. Political economy of PE–bank relationships. **Staple Financing:** sell-side advisor offers a debt package stapled to the sale, generates a second fee stream (debt arranging) for the same bank. Conflict of interest disclosed and usually accepted. **Cross-Sell Pressure:** M&A advisor aggressively pitches buyer for debt mandate. Winning both = 'double dip' = 2x fees. Watch for advisor misalignment. **Fairness Opinions:** £500k–2m separate workstream, usually from a different bank to avoid conflicts, required for public boards. **Cost Allocation in Groups:** fees paid at holdco sometimes pushed down to target via management services agreement → becomes debt-like item in bridge. Watch this — advisor fees can silently shift into the bridge.

SECTION V: FUNDS FLOW — THE PLUMBING OF CLOSING

What It Captures: every cash movement on closing day — sponsor equity, debt drawdown, purchase price, refinancing, break fees, advisor fees, retention payments, escrow funding. Each wire listed by amount, sender, receiver, bank, SWIFT, reference. **Ownership:** buyer's lawyer typically owns the memo, all parties contribute. Final sign-off by ~10 parties (buyer, seller, debt agent, escrow agent, advisors on both sides). **Timing:** week before closing → draft circulated; 48 hours before → final numbers locked; closing day → reconciled in real time against wire confirmations. **Currency:** deal currency (GBP/EUR/USD). Cross-border deals carry FX conversion — FX risk between signing and closing usually borne by buyer.

Typical LBO Funds Flow — £1bn Deal (£400m equity + £600m debt + £200m refinance):

```
SOURCES (INFLOWS)
  1. Sponsor Equity Contribution                    400.0
  2. TLB Drawdown (net of OID)                     594.0
  3. RCF Drawdown (for WC)                            10.0
  4. Target Cash at Close                               25.0
    Total Sources                                            1,029.0

USES (OUTFLOWS)
  1. Equity price to Seller                                820.0
  2. Refinance existing debt                              200.0
  3. Break fees on existing debt                          4.0
  4. Sell-side M&A fee (seller borne)             6.0
  5. Buy-side M&A fee                                      4.0
  6. Debt arranger (OID + commitment)              9.0
  7. Legal & advisor costs                                  5.0
  8. Escrow holdback (tax / price)                25.0
  9. W&I premium                                              1.5
10. Management rollover                               (30.0) no cash
11. Stamp duty, filings                                     0.5
    Total Uses                                                      1,045.0
```

Sources and Uses must reconcile within rounding. Any gap is closed by adjusting the RCF drawdown or a final 'closing cash top-up.'

Paying Agents, Escrow, Custodians:

Paying Agent: bank/trust company (Computershare, Equiniti, BNY Mellon, Wilmington Trust) receives purchase price from buyer, distributes to sellers. Essential in multi-seller deals (public takeovers, roll-up exits, fund distributions to LPs) — buyer pays once, paying agent handles dozens or hundreds of onward wires. **Escrow Agent:** neutral bank holds 5–10% of price for specific indemnity claims, WC true-up, tax exposures. Released on schedule or joint instruction from buyer/seller. **Funding Source Verification:** equity commitment letter from sponsor + debt commitment letter from banks verified by seller's lawyer pre-closing. No funding letters → no closing. **Wire Cut-Off Times:** SWIFT/CHAPS/Fedwire cut off 3–4 PM local. Miss it → next business day → closing delayed. Large deals time closings to sit within a single time zone. **Confirmation Protocol:** each wire confirmed real-time, lawyers tick the line on the master memo. Deal closes only when all lines are ticked.

Closing Day — Hour by Hour:

T-24h: Pre-close checklist — CPs confirmed, funds flow finalised, wire instructions verified, escrow accounts open, paying agent briefed, board approvals in place, reg clearances on file. **T-4h:** Morning call — full team walk through the run-book, each line confirmed, last-minute issues identified. **T-2h:** Debt drawdown — notices filed with admin agent, lenders deliver funds into borrower's account. First wire of the day. **T-1h:** Equity wire and purchase price — sponsor wires equity into acquisition vehicle, buyer wires purchase price to paying agent / seller. Purchase price wire = moment title transfers. **Close:** Signing book released, legal completion effective, stamp duty filings, regulatory notifications. **T+1:** Post-close reconciliation — actual wires vs memo, bill residual advisor costs, issue press release.

When Funds Flow Goes Wrong (All Real):

Wire reversals by compliance hours after closing; wrong account number on £800m wire (3 days to recover); last-minute sanctions flag on seller entity name; debt syndicate funding gap (one bank's internal delay); seller dispute over paying-agent allocation formula; stamp duty calculation error (applied to EV instead of equity); escrow agent signatory out-of-office; FX rate mismatch between signing and closing (0.3% on €1bn = €3m gap filled from buyer operating cash). Every one of these has happened on a large deal.

SECTION VI: CLASSIC PLAYBOOK TRICKS — WHERE REAL MONEY MOVES

The dark arts that differentiate MDs from VPs. None of these are shady or illegal — they are sophisticated interpretations of grey areas within the letter of the SPA. A sharp counterparty spots them; a junior misses them. Know them to deploy or defend.

EBITDA Add-Backs — The Multiplier Move:

On a 10x multiple, every £1m of 'adjusted EBITDA' is £10m of EV. Every QoE presents 'run-rate EBITDA' with aggressive add-backs. **Synergies claimed as run-rate:** 'we announced a cost saving programme in Q2 that will save £8m — only delivered £2m so far but adding back £6m to show run-rate.' Valid if executed; speculative if planned. Demand milestones and discount heavily. **'Non-recurring' that keeps recurring:** restructuring charges five years running are not non-recurring. Legal fees from 'unusual' litigation every year. Inventory write-downs from a 'one-off' SKU rationalisation annually. Review prior-period QoEs — same add-backs recur. **Management fees:** sponsor-backed targets add back the 1–2% sponsor fee — illusory if new owner also charges a similar fee (sponsor buyer); legitimate for a strategic. **CEO transition costs:** double salaries during handover, golden hellos — cumulatively £3–5m. **Run-rate on recent acquisitions:** target bought a sub 5 months ago but presents EBITDA as if owned 12 months. Valid if using acquired actuals, not vendor marketing. **Buyer's defence:** the QoE produces an 'Adjusted EBITDA Bridge' — starting from reported and pressure-testing each add-back. Aggressive buyers haircut 30–50% even if QoE accepts.

EBITDA Period Selection — The £200m Question:

LTM vs Run-Rate: LTM is historical. Run-rate = annualised last quarter × 4. In a growth business, run-rate is 10–20% higher. Sellers insist on run-rate, buyers on LTM. Hybrid 'weighted LTM' often the compromise. **Budget (NTM) vs LTM:** '10x FY+1 budget' uses the seller's forecast. Buyers demand 15–25% discount vs forecast base. **Trailing to signing vs trailing to closing:** a 5-month gap can move EBITDA 5–10%. SPA must specify. **Reference EBITDA:** defined in SPA = LTM EBITDA + adjustments listed on Schedule X. Negotiated line by line. **Seasonality:** signing in a peak month inflates LTM; trough deflates. Best practice: rolling 12-month at same seasonal point year-over-year.

Disclosure Letter Tactics & Warranty Games:

Data Room Dump: in most SPAs, entire data room 'deemed disclosed.' Sellers dump 50k documents — known issues in sub-folder 47 still disclosed. **Fair Disclosure Standard:** UK default — disclosure only counts if prominent, specific, and fair. US default — data room deemed disclosed. Big litigation difference. **General Disclosures:** always-excluded items (facts in public filings, matters in regulatory filings). Sellers expand this list. **Specific Disclosures:** line by line against each warranty. 'Warranty 4.3 — tax. Disclosure: ongoing dispute with HMRC re 2022, quantum £3m.' Blocks that specific warranty. **Knowledge Qualifiers:** 'to the knowledge of the Sellers' — whose knowledge? Defined as 'actual knowledge of CEO, CFO, COO, GC after reasonable enquiry.' The definition of 'reasonable enquiry' is a sub-negotiation. Broad protects sellers, narrow protects buyers. **Disclosure as a Sword:** sometimes sellers disclose items they needn't — signalling 'you knew about this' to neutralise W&I.

Classic Structural Tricks:

Pre-closing dividend / permitted distribution: £50m 'permitted dividend' before closing = price increase disguised as capital return. Treat as top-up to equity price. **Management rollover value:** seller wants fair value × 1.0, buyer wants sweet equity × 0.7 (30% discount for illiquidity/subordination). On £50m rollover → £15m swing. **Deal cost allocation:** who pays for VDD vs buyer DD vs reliance letters. Reliance letter = £200–500k saving. Who captures it? Usually sneakily embedded. **Earn-out definition:** seller wants inclusive EBITDA (all revenue); buyer wants exclusions (new products, M&A, synergies). Typical earn-outs pay 50–70% of max because buyer tilts the definition post-closing. **Reverse termination fees:** if buyer walks (reg failure, financing failure) they pay 3–7% of EV. Sellers push higher, buyers want narrower triggers. **Quiet re-pricing:** post-exclusivity, buyer finds a £20m DD issue — rather than reopen price, pushes for a specific indemnity, higher escrow, or reduced rollover value. Each shifts £20m without touching the headline. Press release stays intact. **Quality-of-Disclosure-Schedule Game:** seller omits 'too small to bother' items — 20 × £500k = £10m of silent warranty risk inherited.

SECTION VII: MEMORISE THIS — THE BRIDGE IN ONE PARAGRAPH

Every M&A bid is denominated in Enterprise Value because EV prices the operating engine and nothing else. To get from EV to the cash that leaves the buyer's account into the seller's, you subtract everything that functions as borrowed money (debt + debt-like), add back everything that functions as free cash (cash, cash-like, WC surplus above peg), net out minorities and associates, apply tax adjustments, compensate the seller for time with a ticker, and claw back any leakage that happened after the economic cut-off. In parallel, the SPA machinery wraps all of this in completion mechanics (locked box vs completion accounts), transfers warranty risk via W&I insurance, pays dozens of advisors whose fees total 3–5% of EV, and orchestrates the whole closing through a funds flow memo where a single wrong digit can delay the deal 24 hours. The seller fights for a high equity price; the buyer for a low one; the advisors fight line by line. The bridge is the single most valuable spreadsheet in any transaction. The answer, always: **EV − net debt − debt-like + cash-like ± WC peg − minorities + associates + ticker − leakage = equity.**