

## Glossary

### A

**Absorption costing** – a.k.a. full costing. Calculated by dividing the total fixed costs incurred during a period by the units sold. The allocated fixed cost is added to the variable cost to give the full cost of the product.

**Accounting** – The process of measuring and summarising financial information about the activities of a business to provide information to shareholders, managers and employees about what is happening in the business.

**Accounts** – The records kept by a business of its financial activities.

**Accrual accounting** – This recognises the occurrence of income and expense irrespective of whether cash has moved in or out of the company at the time the transaction occurs. An example is when a piece of equipment is bought; the expense of the equipment is recorded even through actual payment for it might only be made several months later.

**Activity ratio** – Sales revenues divided by net (or total) assets. This shows the efficiency with which the assets used by the business are being used to generate sales, regardless of the source of the capital. Retail and service industries typically have high activity ratios while manufacturing industries tend to have low activity ratios.

**Acquisition** – The process of taking over a controlling interest in another company. Acquisition also describes any deal where the bidder ends up with 50 per cent or more of the company taken over.

**Acquisition finance** – Companies often need to use external finance to fund an acquisition. This can be in the form of bank debt and/or equity, such as a share issue.

**Advisory board** – An advisory board is common among smaller companies. It is less formal than the board of directors. It usually consists of people, chosen by the company founders, whose experience, knowledge and influence can benefit the growth and direction of the business. The board will meet periodically but does not have any legal responsibilities in regard to the company.

**Alternative assets** – This term describes non-traditional asset classes. They include private equity, venture capital, hedge funds and real estate. Alternative assets are generally more risky than traditional assets, but they should, in theory, generate higher returns for investors.

**Amortisation** – Periodically recorded expenses which show the gradual reduction of value of an asset or an obligation, this usually refers to goodwill, patents and other intangible assets.

**Angel investor** – See business angels

**Asset** – Anything owned by an individual, a business or financial institution that has a present or future value i.e. can be turned into cash. In accounting terms, an asset is something of future economic benefit obtained as a result of previous transactions. Tangible

assets can be land and buildings, fixtures and fittings; examples of intangible assets are goodwill, patents and copyrights.

**Asset (active)** – An asset which is used in the daily operations of the business e.g. cash.

**Asset allocation** – The percentage breakdown of an investment portfolio. This shows how the investment is divided among different asset classes. These classes include shares, bonds, property, cash and overseas investments. Institutions structure their allocation to balance risk and ensure they have a diversified portfolio. The asset classes produce a range of returns - for example, bonds provide a slow but steady return, equities a higher but riskier return. Cash has a guaranteed return. Effective asset allocation maximises returns while covering liabilities.

**Assets (current)** – Cash or assets convertible into cash at short notice

**Asset (fixed)** – A long-term, tangible asset held for business use and not expected to be converted to cash in the current or upcoming fiscal year, such as manufacturing equipment, real estate, and furniture.

**Assets (intangible)** – Are items such as patents, copyrights, trademarks, licenses, franchises, and other kinds of rights or things of value to a company, which are not physical objects. These assets may be the most important ones a company owns. Often they do not appear on financial reports.

**Asset (liquid)** – Assets in the form of cash (or easily convertible into cash)

**Asset (net)** – Total assets minus total liabilities of an individual or company. The net asset figure therefore can be used as a measure of the value of the business. It is the value of everything the business owns after all the debts have been taken account of.

**Auditing** – The process of checking the books and accounting systems of a company to verify that the company's accounts give a fair and true view of its financial situation.

**Authorised capital** – The amount of share capital that the company has been authorised to issue. Stamp duty is paid at the time of authorisation, and if the directors wish to issue further shares once the authorised capital is fully issued, they must get approval from the shareholders. Once issued, shares may be issued at the discretion of the company's board of directors.

## **B**

**Bad debts** – Debtors that will never be collected. To "write off" a bad debt means reducing the debt figures by the amount written off, and putting the amount in the profit and loss account as an expense against profit.

**Balance Sheet** – A financial statement that shows what a business owns and what it owes at a certain date. Also called a statement of financial position.

**Balanced fund** – A fund that spreads its investments between various types of assets such as stocks and bonds. Investors can avoid excessive risk by balancing their investments in this manner, but should expect only moderate returns.

**Benchmark** – This is a standard measure used to assess the performance of a company. Investors need to know whether or not a company is hitting certain benchmarks as this will determine the structure of the investment package. For example, a company that is slow to reach certain benchmarks may compensate investors by increasing their stock allocation.

**BIMBO 'buy-in management buy-out'** – A BIMBO enables a company to re-shuffle its allocation of share capital to bring about a change in management. Internally, a group of managers will acquire enough share capital to 'buy out' the company from within. An outside team of managers will simultaneously 'buy in' to the company management. Both parties may require financial assistance from venture capitalists in order to achieve this end.

**Bond** – a type of IOU issued by companies or institutions. They generally have a fixed interest rate and maturity values, so they're very low risk - much less risky than buying equity - but their returns are accordingly low.

**Bootstrapping** – Bootstrapping means starting and operating a business with little or no money or assistance from outside investors. It requires a business model based on the early generation of revenue to sustain business growth.

**Break-even point** – The volume of sales at which total sales equals total costs, and the company makes neither profit nor loss.

**Bridge loan** – a kind of short-term financing that allows a company to continue running until it can arrange longer-term financing. Companies sometimes seek this because they run out of cash before they receive long-term funding; sometimes they do so to strengthen their balance sheet in the run up to flotation.

**Budget** – A management plan for financial achievement over a specified period. This needs to be supported by an action plan that will give rise to the required financial results. The budget is a good way of co-ordinating the activities of different departments within a company.

**Burn rate** – the rate at which a start-up uses its venture capital funding before it begins earning any revenue.

**Business Angel** – A business angel is an affluent individual who provides capital for a business, usually in small or start up businesses in exchange for ownership equity. Unlike venture capitalists, angels typically do not manage the pooled money of others in a professionally-managed fund. However, angel investors often organise themselves into angel networks or angel groups to share research and pool their own investment capital, otherwise known as syndicates. Angels are also sometimes willing and able to provide hands on experience and involvement.

**Business Model** – The combination of factors that describe the business, including the market the business will serve, the perceived value delivered to the customer, which determines profitability per unit of sale, and the sustaining factors that allow the company to thrive over the long term

**Business Plan** – A business plan is a summary of how a business owner intends to organise an entrepreneurial endeavour and implement activities necessary and sufficient for the venture to succeed and achieve its goals. It is a written explanation of the company's business model.

**Buy-out** – This is the purchase of a company or a controlling interest of a corporation's shares. This often happens when a company's existing managers wish to take control of the company. See management buy-out

## C

**Capital** – Sum of money borrowed from a lender.

**Capital Allowance** – A tax advantage that a company is granted for money that it spends on fixed assets e.g. taking account of depreciation of certain types of business assets such as plant and machinery and motor vehicles etc.

**Capital commitment** – Every investor in a private equity fund commits to investing a specified sum of money in the fund partnership over a specified period of time. The fund records this as the limited partnership's capital commitment. The sum of capital commitments is equal to the size of the fund. Limited partners and the general partner must make a capital commitment to participate in the fund.

**Capital distribution** – These are the returns that an investor in a private equity fund receives. It is the income and capital realised from investments less expenses and liabilities. Once a limited partner has had their cost of investment returned further distributions are actual profit. The partnership agreement determines the timing of distributions to the limited partner. It will also determine how profits are divided among the limited partners and general partner.

**Capital expenditure** – The purchase of fixed assets.

**Capital gain** – When an asset is sold for more than the initial purchase cost, the profit is known as the capital gain. This is the opposite of capital loss, which occurs when an asset is sold for less than the initial purchase price. Capital gain refers strictly to the gain achieved once an asset has been sold - an unrealised capital gain refers to an asset that could potentially produce a gain if it was sold. An investor will not necessarily receive the full value of the capital gain - capital gains are often taxed; the exact amount will depend on the specific tax regime.

**Capital Gearing** – Is the total value of long-term borrowed funds, overdrafts and short-term loans divided by the value of the shareholders' funds. It is a key measure of a company's long term liquidity and therefore of its ability to survive and grow.

**Capital Growth** – The rise in the value of an initial investment, and any income that has been added to it.

**Capital under management** – This is the amount of capital that the fund has at its disposal, and is managing, for investment purposes.

**Capital Stake** – A share holding or investment in a company.

**Captive firm** – A private equity firm that is tied to a larger organisation, typically a bank, insurance company or corporate.

**Carried interest** – The share of profits that the fund manager is due once it has returned the cost of investment to investors. Carried interest is normally expressed as a percentage of the total profits of the fund. The industry norm is 20 per cent. The fund manager will normally therefore receive 20 per cent of the profits generated by the fund and distribute the remaining 80 per cent of the profits to investors.

**Cash** – Literally money, or money in bank accounts that can be withdrawn at short notice.

**Cash Flow** – The cash, as opposed to the profit, generated by a business. The difference between cash and profit is important for example a cash rich business is a super store. The store buys in goods but usually will only pay the resulting invoice in 6 months time. The store however receives cash from customers buying the goods immediately. This is in contrast to the company which sells the goods to the super store – they have made a profit because they have sold the goods with an additional price mark up from what they originally paid for them, however they actually have less cash than they did though their books would show a profit.

**Cashflow Forecast** – A projection of the expected movements of cash in and out of the company over a given period.

**Catch up** – A clause that allows the general partner to take, for a limited period of time, a greater share of the carried interest than would normally be allowed. This continues until the time when the carried interest allocation, as agreed in the limited partnership, has been reached. This usually occurs when a fund has agreed a preferred return to investors - a fund may return the cost of investment, plus some other profits, to investors early.

**CHAPS** – (Clearing House Automated Payments System). An electronic system allowing the payment to go from the paying bank to the receiving bank on the same day, there is usually a charge for this service.

**Chairman's statement** – A statement made by the company's chairman about its activities during the past accounting period, and its plans and prospects for the future. It is usually part of the annual report.

**Clawback** – A clawback provision ensures that a general partner does not receive more than its agreed percentage of carried interest over the life of the fund. So, for example, if a general partner receives 21 percent of the partnership's profits instead of the agreed 20 per cent, limited partners can claw back the extra one per cent.

**Clearing Bank** – Any bank that is a member of any of the constituent companies of APACS.

**Clearing House** – Central collection site where banks exchange cheques with one another.

**Closing** – This term can be confusing. If a fund-raising firm announces it has reached first or second closing, it doesn't mean that it is not seeking further investment. When fund raising, a firm will announce a first closing to release or drawdown the money raised so far so that it can start investing. A fund may have many closings, but the usual number is around three. Only when a firm announces a final closing is it no longer open to new investors.

**Co-investment** – Although used loosely to describe any two parties that invest alongside each other in the same company, this term has a special meaning when referring to limited partners in a fund. If a limited partner in a fund has co-investment rights, it can invest directly in a company that is also backed by the private equity fund. The institution therefore ends up with two separate stakes in the company - one indirectly through the fund; one directly in the company. Some private equity firms offer co-investment rights to encourage institutions to invest in their funds.

**Commercial Mortgage** – A long term loan secured by business premises.

**Company buy-back** – The process by which a company buys back the stake held by a financial investor, such as a private equity firm. This is one exit route for private equity funds.

**Conditions Precedent** – Certain conditions that a venture capitalist may insist are satisfied before a deal is completed

**Contingency** – The planned allotment of time, cost or other resources for unforeseeable elements and events in a project

**Corporate Venturing** – Corporate venturing is the process of two companies entering into a mutually beneficial partnership. Usually in this form of relationship the larger of the two companies will invest either money or goods and services into the smaller company in return for access to technology or skills held by the smaller.

**Covenants** – Conditions imposed on loans and bonds to protect lenders against default.

**Credit** – Money received.

**Credit Control** – Making sure that customers of a business pay the amount owed on time.

**Creditors / Accounts payable (US)** – Money owing to suppliers for goods and services purchased but not yet paid for.

**Current Asset Ratio** – The key indicator of whether a company can pay their creditors on time.

**Current Liabilities** – Usually appearing on a company's balance sheet, it represents the amount owed for interest, accounts payable, short-term loans, expenses incurred but unpaid and other debts due within one year. Essentially these are the bills that are due very

shortly, usually less than one year. Non-current liabilities are long term liabilities with a future benefit of over one year. An example is notes payable that mature greater than one year.

## D

**Debenture** – A type of long term bond (loan), taken out by a company, which it agrees to repay at a specified future date. The company will usually pay a fixed rate of interest to debenture holders each year until maturity, and if it fails to pay either the interest or the principal amount of the loan when the time comes, the debenture holders can force the company into liquidation and recover their money from a sale of the company's assets.

**Debt** – Financing items on which there is a commitment to pay interest and usually commitment to repay. Usually a debt provider has some security to ensure there is no loss.

**Debt consolidation** – Debt consolidation is the replacement of multiple loans with a single loan, often with a lower monthly payment and a longer repayment period. It can also be called a consolidation loan.

**Debt financing** – This is raising money for working capital or capital expenditure through some form of loan. This could be by arranging a bank loan or by selling bonds, bills or notes (forms of debt) to individuals or institutional investors. In return for lending the money, the individuals or institutions become creditors and receive a promise to repay principal plus interest on the debt.

**Debtors / Accounts receivable (US)** – Money owing from customers for goods or services supplied and invoiced, but not yet paid for.

**Debenture** - A legal document that formalises the lenders charge over the assets of the company.

**Debit** - A payment.

**Deferred Taxes** – Taxes that have already been charged against profits in the Profit and Loss account, but have not yet been paid. They show on the balance sheet as a current liability.

**Deflation** - A decline in the general level of prices in the economy.

**Depreciation** – Is a way of charging the cost of using an asset (which will eventually have to be replaced) against the periods during which it is used. A portion of the cost is deducted from the balance sheet value each year and put in the Profit and Loss account as an expense though no cash transactions occur. At the end of the asset's expected life it is "written off" or listed as having no value though it may still be working well and indeed have some market value.

**Depreciation/Staff Costs (%)** – Is the depreciation expressed as a percentage of staff costs. Therefore it is a measure of the relationship between capital equipment and staff (capital intensity). Highly automated businesses will have a high depreciation/staff costs percentage. Labour-intensive businesses will have a low percentage.

**Derivative** – Financial contract with a value linked to the expected future price movements of the asset it is linked to - such as a share or a currency.

**Discounting** – Means of raising money against the value of unpaid invoices.

**Distressed debt (otherwise known as vulture capital)** – This is a form of finance used to purchase the corporate bonds of companies that have either filed for bankruptcy or appear likely to do so. Private equity firms and other corporate financiers who buy distressed debt don't asset-strip and liquidate the companies they purchase. Instead, they can make good returns by restoring them to health and then prosperity. These buyers first become a major creditor of the target company. This gives them leverage to play a prominent role in the reorganisation or liquidation stage.

**Dividends** – Payment from profits to the shareholders. Dividends paid out will be shown on the bottom of the Profit and Loss account while dividends proposed but not yet paid will be among the current liabilities on the balance sheet.

**Dividend cover** – A dividend is the amount of a company's profits paid to shareholders each year. Dividend cover is the calculation used to show how much of a company's after-tax profit is being used to finance the dividend. The formula is:  $\text{Dividend Cover} = (\text{Earnings per share} / \text{Dividend per share})$ .

**Dividend/Earnings (%)** – Is the dividend expressed as a percentage of earnings. Thus it measures the balance between the immediate rewards for shareholders and reinvestment for the future.

**Drawdown** – When a venture capital firm has decided where it would like to invest, it will approach its own investors in order to draw down the money. The money will already have been pledged to the fund but this is the actual act of transferring the money so that it reaches the investment target.

**Dry Close (Dry Closing)** – A dry close is when a private equity firm raises money for a fund early on in the cycle, but then agrees to not levy any management fees on the money raised from its Limited Partners until it actually begins investing the fund. Most private equity firms will start raising a new fund when their current fund is around 70% invested. Venture firms tend to raise new funds earlier than buy-out firms, because they usually need to invest in follow-on rounds for their portfolio firms.

**Due Diligence** – Investing successfully in private equity at a fund or company level, involves thorough investigation. As a long-term investment, it is essential to review and analyse all

aspects of the deal before signing. Capabilities of the management team, performance record, deal flow, investment strategy and legal, are examples of areas that are fully examined during the due diligence process.

## E

**Early-stage finance** – This is the realm of the venture capital - as opposed to the private equity - firm. A venture capitalist will normally invest in a company when it is in an early stage of development. This means that the company has only recently been established, or is still in the process of being established - it needs capital to develop and to become profitable. Early-stage finance is risky because it's often unclear how the market will respond to a new company's concept. However, if the venture is successful, the venture capitalist's return is correspondingly high.

**Earnings per share (EPS)** – Net profit divided by the number of ordinary shares issued. A measure of the efficiency with which shareholders' funds are being used to generate profit, which can then be used either to expand the business and increase the value of the assets, or to pay dividends.

**EBIT** – Earnings before interest and tax.

**EBITDA** – Earnings before interest, tax, depreciation and amortisation.

**E-Commerce** – Business conducted over the Internet and other electronic networks.

**Enterprise Investment Scheme (EIS)** – Is a series of tax reliefs designed to encourage investments in small unquoted companies carrying on a qualifying trade in the UK. The purpose of the EIS was because investment in companies that are not listed on a stock exchange often carries a high risk. The tax relief is intended to offer some compensation for that risk. The EIS offers both income tax and capital gains tax reliefs to investors who subscribe for shares in qualifying companies. The rules for companies qualifying are complicated so please look on the EIS website for more information. However, in brief some of the following qualifications must be met; the Company must not have assets greater than £7million, all capital employed must be actively engaged in the company within 24 months, the Company must not be in specific industries, entry into the scheme is subject to a decision and audit made by an appointed tax officer, the company must not be listed or have any intention of becoming listed at the time of the investment.

**Equity** – The net worth, or balance sheet value, of a business to its owners. If all the assets were sold off at their present book value, and all the loans and other debts repaid, the remainder would be the shareholders' equity.

**Equity financing** – Companies seeking to raise finance may use equity financing instead of or in addition to debt financing. To raise equity finance, a company creates new ordinary shares and sells them for cash. The new share owners become part-owners of the company and share in the risks and rewards of the company's business.

**Equity Gearing** – The relationship between Equity provided as Ordinary shares and Preference Shares

**Evergreen fund** – A fund in which the returns generated by its investments are automatically channelled back into the fund rather than being distributed back to investors. The aim is to keep a continuous supply of capital available for further investments.

**Exchange Rate** – The value of one currency compared to another.

**Exit (Exit route)** – Private equity professionals have their eye on the exit from the moment they first see a business plan. An exit is the means by which a fund is able to realise its investment in a company - by an initial public offering, a trade sale, selling to another private equity firm or a company buy-back. If a fund manager can't see an obvious exit route in a potential investment, then it won't touch it. Funds have the power to force an investee company to sell up so they can exit the investment and make their profit, but venture capitalists claim this is rare - the exit is usually agreed with the company's management team.

## **F**

**Factoring** – Is where a factoring company buys a business's invoices at a discount and takes responsibility for collecting the payments due on them. This process brings cash to the business due from the customer, sooner than the terms that the invoice would normally allow.

**Fair Market Value** – The price a willing buyer would pay to a willing seller if neither was under any compulsion to make the deal.

**Financed Items** – The assets (such as Fixed and Intangible Assets, and working capital (stock and debtors, less current liabilities such as Creditors)) needed to make a business operate.

**Financial accounting** – The preparation of annual reports and other items for external interested parties, and to satisfy the legal requirements of the government.

**Financial cash flow** – The net cash flow resulting from changes in loans, share capital and payment of dividends.

**Financial Design** – Ensuring that the rules associated with each type of finance are met by the business proposition

**Financial Packaging** – The process of bringing together various funding instruments to help with a round of funding

**Finance Lease** – A finance lease or capital lease is a lease which meets at least one of the following criteria:

- the lease term is greater than 75% of the asset's estimated economic life
- the lease contains an option for the lessee to purchase the asset for less than fair market value

- ownership of the asset is transferred to the lessee at the end of the lease term
- the present value of the lease payments exceeds 90% of the fair market value of the asset.

**First time fund** – This is the first fund a private equity firm ever raises - whether the firm is made up of managers who have never raised a fund before or, as in many cases, the firm is a spin-off, where managers from different, established funds have joined forces to create their own, new firm. In the first instance, the managers do not have a track record so investing with them can be very risky. In the second instance, the managers will have track records from their previous firms, but the investment is still risky because the individuals are unlikely to have worked together as a team before.

**Flotation** – The process of changing a private company into a public company by issuing shares and soliciting the public to purchase them.

**Follow-on funding** – Companies often require several rounds of funding. If a private equity firm has invested in a particular company in the past, and then provides additional funding at a later stage, this is known as 'follow-on funding'.

**Footsie (FTSE 100)** – This is the main UK share index representing the price of the top 100 shares.

**Fund of funds** – A fund set up to distribute investments among a selection of private equity fund managers, who in turn invest the capital directly. Fund of funds are specialist private equity investors and have existing relationships with firms. They may be able to provide investors with a route to investing in particular funds that would otherwise be closed to them. Investing in fund of funds can also help spread the risk of investing in private equity because they invest the capital in a variety of funds.

**Fund raising** – The process by which a private equity firm solicits financial commitments from limited partners for a fund. Firms typically set a target when they begin raising the fund and ultimately announce that the fund has closed at such-and-such amount. This may mean that no additional capital will be accepted. But sometimes the firms will have multiple interim closings each time they have hit particular targets (first closings, second closings, etc.) and final closings. The term cap is the maximum amount of capital a firm will accept in its fund.

**Funding Requirement** – The amount of funds needed to bring the project to profitability and cash generation

## G

**Gatekeeper** – Specialist advisers who assist institutional investors in their private equity allocation decisions. Institutional investors with little experience of the asset class or those with limited resources often use them to help manage their private equity allocation. Gatekeepers usually offer tailored services according to their clients' needs, including private equity fund sourcing and due diligence through to complete discretionary mandates. Most gatekeepers also manage funds of funds.

**Gearing** – The relationship between a company's debt and its share capital and accumulated reserves. Highly geared companies tend to be more vulnerable than those that borrow less in relation to their shareholders' funds.

**General partner** – This can refer to the top-ranking partners at a private equity firm as well as the firm managing the private equity fund.

**General partner contribution/commitment** – The amount of capital that the fund manager contributes to its own fund. This is an important way for limited partners to ensure that their interests are aligned with those of the general partner.

**Goodwill** – When a business is sold, the price paid is usually greater than the total asset value as shown on the balance sheet. The difference, which represents the buyer's expectation that it will generate profits in future, is called goodwill, and is put among the fixed assets of the buying company balance sheet. Goodwill is usually depreciated over the first few years after the purchase.

**Grant** – A sum of money that is given to your business after an application process has been followed. There is no interest to be paid and funds are not usually returnable - as long as the terms of the grant are met.

**Gross** – Before deduction of tax, not to be confused with net which is after tax.

**Gross margin** – Gross profit. Sales less cost of sales, less factory overheads in a manufacturing business.

**Gross Assets** – Original value of an asset that usually coincides with the buying price or production cost, without write-downs or depreciation allowance having been applied.

**Gross Domestic Product** – The value of the goods and services produced by an economy.

## H

**Hire Purchase** – The right to purchase an asset by the user of the asset according to a pre-agreed method. The user may be the owner for tax purposes.

**Historical cost** – The actual cost of buying an asset at the time it was purchased.

**Holding period** – This is the length of time that an investment is held. For example, if Company A invests in Company B in June 1996 and then sells its stake in June 1999, the holding period is three years.

## I

**Incentive Ratchet** – A strategy sometimes used by investors to reduce the level of risk in an investment. For instance, preference shares may be redeemed if agreed targets are reached, but converted to ordinary shares if agreed targets are undershot. Thus, an investor can build some certainty of reaching his target returns by passing more risk to the existing owner.

**Incremental cost** – The extra cost associated with an action, e.g. hiring a staff member.

**Incubator** – An entity designed to nurture business ideas or new technologies to the point that they become attractive to venture capitalists. An incubator typically provides physical space and some or all of the services - legal, managerial, technical - needed for a business idea to be developed. Private equity firms often back incubators as a way of generating early-stage investment opportunities. A local example of an incubator is Set Squared.

**Indemnity** – An indemnity arises when one individual takes on the obligation to pay for any loss or damage that has been or might be incurred by another individual.

**Inflation** – The term for general price increases.

**Initial public offering (IPO)** – An IPO is the official term for 'going public'. It occurs when a privately held company - owned, for example, by its founders plus perhaps its private equity investors - lists a proportion of its shares on a stock exchange. IPOs are an exit route for private equity firms. Companies that do an IPO are often relatively small and new and are seeking equity capital to expand their businesses.

**Insolvency** – It is experienced by a business entity when assets no longer exceed their liabilities or when the entity can no longer meet its debt obligations when they come due.

**Institutional buy-out (IBO)** – If a private equity firm takes a majority stake in a management buy-out, the deal is an institutional buy-out. This is also the term given to a deal in which a private equity firm acquires a company outright and then allocates the incumbent and/or incoming management a stake in the business.

**Interest** – A payment for the use of money, for example an additional payment of top of money borrow from a bank or other type of lender.

**Interest Gearing** – How many times interest costs in a company's profit and loss account are covered by profit, before interest and tax.

**Interest Margin** – The margin between the interest someone pays their lender and what the lender has to pay for the money in the first place.

**Interest Rate** – The cost of credit, expressed as a percentage rate.

**Internal rate of return (IRR)** – This is the most appropriate performance benchmark for private equity investments. In simple terms, it is a time-weighted return expressed as a percentage. IRR uses the present sum of money invested; the present value of money returned from investments and the current value of unrealised investments and applies a discount.

**Investor** – An organization, corporation, individual, or other entity that acquires an ownership position in an investment, assuming risk of loss in exchange for anticipated returns, see *business angel*.

**Investment** – The funds that an investor provides to allow a project go ahead usually in return for interest payments or equity returns.

**Investment Readiness** – The state reached when a business has a plan and forecast that allows those who are intending to invest to gain confidence in the proposition and understand the risks. A business should be investment ready before attempting to raise finance.

**Invoice Discounting** – instant cash upon issuing invoices that does not require sales ledger and collection services.

**Iterative process** – A process that is repeated until the all conditions (of financiers) are satisfied.

## J

**Junk Bonds** – Bonds issued by companies with a very small asset base and consequently offering a high-risk investment, typically with high interest.

## L

**Later stage finance** – Capital that private equity firms generally provide to established, medium-sized companies that are breaking even or trading profitably. The company uses the capital to finance strategic moves, such as expansion, growth, acquisitions and management buy-outs.

**Lead investor** – The investor that is taking a lead position in an investment in a company, usually because they are investing the largest portion of a syndicated investment but sometimes because they are most knowledgeable about a company or have made the first commitment to an investment and are leading the due diligence process. Typically a Lead Investor will have a board seat.

**Leasehold Property** – Property held under a lease.

**Letters of Credit** – A written instrument from a bank or merchant in one location that requests that anyone or a specifically named party advance money or items on credit to the party holding or named in the document.

**Leveraged buy-out (LBO)** – The acquisition of a company using debt and equity finance. As the word leverage implies, more debt than equity is used to finance the purchase, e.g. 90% debt to ten% equity. Normally, the assets of the company being acquired are put up as collateral to secure the debt.

**Limited Company** – In the United Kingdom or Ireland a limited company is a corporation whose liability is limited by shares (Ltd), which is the most common form of privately held company. The company has shareholders and a memorandum of agreement.

**Limited Liability** – The liability of a firm's owners for no more capital than they have invested in the business

**Limited partnership** – The standard vehicle for investment in private equity funds. A limited partnership has a fixed life, usually of ten years. The partnership's general partner makes investments, monitors them and finally exits them for a return on behalf the investors - limited partners. The GP usually invests the partnership's funds within three to five years and, for the fund's remaining life, the GP attempts to achieve the highest possible return for each of the investments by exiting. Occasionally, the limited partnership will have investments that run beyond the fund's life. In this case, partnerships can be extended to ensure that all investments are realised. When all investments are fully divested, a limited partnership can be terminated or 'wound up'.

**Liquidity** – The unused cash resources of a business. It can include unused borrowings. A business with high liquidity can consider ambitious long term plans, whereas a business with low liquidity must take short term measures to ensure survival so that the Equity base and cash resources are rebuilt.

**Lock-up period** – A provision in the underwriting agreement between an investment bank and existing shareholders that prohibits corporate insiders and private equity investors from selling at IPO, see *initial public offering*.

**Loss** – When the costs and expenses during a period are greater than the sales revenue, the business makes a loss, and the share-holder's equity is reduced by the amount of the loss.

## **M**

**Management buy-in (MBI)** – Purchase of a business by an outside team of managers who have found financial backers and plan to manage the business actively themselves. An MBI is likely to happen if the internal management lacks expertise or the funding needed to 'buy out' the company from within. It can also happen if there are succession issues - in family businesses, for example, there may be nobody available to take over the management of the company. An MBI can be slightly riskier than a MBO because the new management will not be as familiar with the way the company works.

**Management buy-out (MBO)** – Term used for the funds provided to enable operating management to acquire a product line or business, which may be at any stage of development, from either a public or private company. This is one of the least risky types of private equity investment because the company is already established and the managers running it know the business - and the market it operates in - extremely well.

**Management fee** – Is a periodic payment that is paid by investors in a pooled investment fund to the fund's investment adviser for investment and portfolio management services.

**Margin** – The difference between the cost of money and the rate received on it.

**Marginal costing** – Determining the cost of selling one additional item, usually direct labour and materials, plus any variable overheads such as sales commission.

**Market leader** – The company with greatest sales in a given market is the leader. In some markets the leader's share is very high, but in most markets the leader has no more than 15 – 20% of the market.

**Market value** – The amount for which an asset can be sold.

**Mezzanine Finance** – A halfway house between equity finance and ordinary debt finance, usually as part of a venture capital finance package. Sometimes unsecured, sometimes secured by a second charge on the company's assets, therefore more expensive than ordinary loans.

**Milestone** – An objective set for a round of funding

**Minority Protection Rights** – Minority protection rights as those required to safeguard a financial interest which include the right for its shareholding not to be diluted without consent

**Mortgage** – A charge over property securing a long term loan

**Mutuality** – Where an organisation is owned by its members without outside shareholders.

## **N**

**Net** – After tax has been deducted.

**Net assets** – is total assets less current liabilities. It is a measure of the capital worth of the company.

**Net Tangible Assets (NTAs)** – The shareholders' funds in a business; the difference between the total assets less any intangible assets like goodwill and the total of current and term liabilities. Also known as tangible net worth.

**Net Worth** – Net worth is the difference between the total assets and the total current and term liabilities. Also known as (equity) shareholders' funds, equity or net assets.

**Not-for-profit Business** – A corporation or an association that conducts business for the benefit of the general public without shareholders and without a profit motive. These organisations cannot distribute corporate income to shareholders. The funds acquired by nonprofits corporations must stay within the corporate accounts to pay for reasonable salaries, expenses, and the activities of the corporation.

## **O**

**OFEX** – A facility used for trading in stocks that are not quoted on any London stock exchange.

**Operating Lease** – A lease contract that allows the use of an asset, but does not convey rights similar to ownership of the asset.

**Operating Profit** – Is calculated by subtracting from sales or turnover the cost of sales, distribution and administration and other costs. Since it does not include interest charges (which are influenced by the mix of funding between shareholders and bankers) it provides a measure of the trading success of the core business.

**Operating Profit/Employee** – Is the operating profit divided by the number of employees. It provides a measure of the effectiveness of the company's human resources.

**Operating Profit/Sales (%)** – Is the operating profit expressed as a percentage of the value of sales. Therefore it measures how efficient the company is at gaining sales. It normally ranges from 3% to 20% depending on the industry, degrees of competition and risk, the efficiency of the business and the value added.

**Operating Profit/Total Assets** – Is the operating profit expressed as a percentage of the total assets. Thus it measures the profitability of the business from the viewpoint of managerial efficiency. It normally ranges between 9% and 17% depending on the industry, degrees of competition and risk, and the efficiency of the business.

**Ordinary Shares** – Ordinary shares are also known as equity shares and they are the most common form of share in the UK. An ordinary share gives the right to its owner to share in the profits of the company (dividends) and to vote at general meetings of the company.

**Other Costs** – Includes marketing and research & development expenses.

**Other Liabilities** – Includes taxes owed (other than current corporation tax), the value of unpaid leases on fixed assets etc.

**Overdraft** – When a person or business borrows from their bank and is allowed to take out more money than they have in their account. If the overdraft is not agreed prior to taking out money not in your account you are likely to be subject to charges.

**Overdraft & Short-Term Loans** – Is the total of all the borrowings that are due to be repaid during the next twelve months.

**Overheads** – Expenses of the business that do not contribute directly to the value of the product or service provided. Generally, fixed costs.

**Over Trading** – Driving up sales to the point where the business runs out of working capital and may fail.

**Owners' equity** – Net worth. The total of share capital and reserves. The total funds invested by shareholders for the purchase of shares, and profits reinvested by the company. Total assets less total liabilities.

## **P**

**Partnership** – Business carried out by two or more people where each is jointly liable for the debts of the business.

**PAYE** – Scheme set up by businesses to pay income tax and National Insurance contributions to the Inland Revenue from employees' earnings.

**Personal Guarantee** – An agreement to make oneself liable or responsible to another for the payment of a debt, default or performance of a duty by a third party.

**Placement agent** – Placement agents are specialists in marketing and promoting private equity funds to institutional investors. They typically charge two per cent of any capital they help to raise for the fund.

**Portfolio** – A private equity firm will invest in several companies, each of which is known as a portfolio company. The spread of investments into the various target companies is referred to as the portfolio.

**Portfolio company** – This is one of the companies backed by a private equity firm.

**Preferred return** – This is the minimum amount of return that is distributed to the limited partners until the time when the general partner is eligible to deduct carried interest. The preferred return ensures that the general partner shares in the profits of the partnership only after investments have performed well.

**Preference Shares** – Preference shares offer their owners preferences over ordinary shareholders. There are two major differences between ordinary and preference shares 1) preference shareholders are often entitled to a fixed dividend even when ordinary shareholders are not and; 2) preference shareholders cannot normally vote at general meetings.

**Price/Earnings Ratio** – Is the current Stock Exchange value of the company compared with the profits earned. Thus it is a measure of the shareholders' return. The value varies depending on the industry; degree of competition, risk and business efficiency but a typical figure is about 11. The value varies also according to the shareholders' expectations for the company. For example, a "blue chip" company will have a lower ratio than a growth company (whose shareholders expect the value of their holdings to appreciate as the company grows).

**Private equity** – This refers to the holding of stock in unlisted companies – companies that are not quoted on a stock exchange. It includes forms of venture capital and MBO financing.

**Private placement** – When securities are sold without a public offering, this is referred to as a private placement. Generally, this means that the stock is placed with a select number of private investors.

**Profit and Loss Account** – is a key account providing information describing how the company has been trading over a period of time. Therefore it provides information on sales, expenditures, profit and tax.

**Profitability** – Measures the relationship between the profits earned and the amount of financial resources necessary to earn the profit. Thus the basic measure expresses a return (Profit) as a percentage of an investment. Additionally, measures of profitability must be from two viewpoints, those of management and of shareholders.

**Pseudo Equity** – Equity which is borrowed by the business by using the security of the shareholder/owner which can be treated as Equity, but has a commitment to pay interest.

**Public to private** – This is when a quoted company is taken into private ownership – more recently by private equity firms. Historically, this has involved a large company selling one of its divisions. A new trend has been for whole companies to be bought out and subsequently delisted.

## Q

**Quick Ratio** – Is the current assets less stocks divided by the current liabilities. Like the current ratio, it is a key measure of liquidity. It measures the company's short-term ability to pay its bills. By excluding the value of stock from the value of current assets, it takes into account the fact that a common cause of business problems is the inability to sell the right products. If the products are wrong, the value of stock will include products that may be unsaleable, except at a heavily discounted price. It is generally accepted that this measure should approximate 1.0. If it is substantially below this figure then suppliers and bankers will be concerned about the company's ability to pay its bills. If it is substantially above this figure, then the company's current assets are at an inefficient level.

## R

**Ratchets** – This is a structure that determines the eventual equity allocation between groups of shareholders. A ratchet enables a management team to increase its share of equity in a company if the company is performing well. The equity allocation in a company varies, depending on the performance of the company and the rate of return that the private equity firm achieves.

**Ratio analysis** – Ratios between balance sheet items or Profit and Loss account items often provide an insight into the level of risk in a company, its effectiveness at generating profit for the shareholders and so forth.

**Raw Stocks** – Is the total value of raw material stocks on hand at the end of the period.

**Recapitalisation** – This refers to a change in the way a company is financed. It is the result of an injection of capital, either through raising debt or equity.

**Receivership** – After a company has defaulted, the appointment of a licensed insolvency practitioner to realise the value of the assets to repay outstanding debts.

**Regional Venture Capital Funds** – Regional Venture Capital Funds (RVCFs) are an England wide programme to provide finance of up to £500,000 to early stage businesses

**Regulations** – Laws and rules derived from legislation or treaties.

**Retail Price Index (RPI)** – The official measure of inflation calculated by weighting the costs of goods and services to approximate a typical family spending pattern.

**Retained Profit** – Is the value of the proportion of profit accruing to shareholders that has been retained for the future expansion of the business. (Therefore it equals earnings less dividends.)

**Return on Capital Employed** – Is the operating profit expressed as a percentage of the capital employed. Thus it is a key measure of the profitability of the "core" business.

Therefore it is a key measure of the effective management of the core business. The normal range is 13% to 25%.

**Return on equity (ROE)** – Net income/net profit divided by total shareholders' equity. A measure of the effectiveness of the business in utilising shareholders' funds to generate wealth. It does not tell how much of the profit was paid out in dividends, and how much was retained as reserves.

**Return on investment (ROI)** – A measure of the ability of the business to use the money invested in it to generate profits.

**Return on net assets (RONA)** – Operating profit divided by net assets. The key measure of operating management performance. It removes the effects of financing decisions and tax and shows the ability of the business to cover interest charges and use loan financing.

**Return on sales (ROS)** – Profit or earnings as a percentage of sales.

**Revolving facility** – A loan (such an overdraft) that is technically 'rolled over' by the lender at frequent intervals

**Risk Capital** – The money that a person allocates to investments in high risk securities.

## S

**Sales or Turnover** – Is the net value of sales made during the period.

**Sales per Employee** – Are the average level of sales income earned per employee.

**Sales/Total Assets** – Is the value of sales divided by the total asset value. Therefore it is a key measure of the efficiency of the use of the company's capital resources. It is particularly significant in high fixed-cost companies. (It is also called Asset Turn).

**Secondaries** – The term for the market for interests in venture capital and private equity limited partnerships from the original investors, who are seeking liquidity of their investment before the limited partnership terminates. An original investor might want to sell its stake in a private equity firm for a variety of reasons: it needs liquidity, it has changed investment strategy or focus or it needs to re-balance its portfolio. The main advantage for investors looking at secondaries is that they can invest in private equity funds over a shorter period than they could with primaries.

**Secondary buy-out** – A common exit strategy. This type of buy-out happens when an investment firm's holding in a private company is sold to another investor. For example, one venture capital firm might sell its stake in a private company to another venture capital firm.

**Secondary market** – The market for secondary buy-outs. This term should not be confused with *secondaries*.

**Second stage funding** – The provision of capital to a company that has entered the production and growth stage although may not be making a profit yet. It is often at this stage that venture capitalists become involved in the financing.

**Security** – An asset which is offered by a borrower to a lender to safeguard a loan.

**Seed capital** – The provision of very early stage finance to a company with a business venture or idea that has not yet been established. Capital is often provided before venture capitalists become involved. However, a small number of venture capitalists do provide seed capital.

**Share** – An investment in, and part ownership of, a company.

**Shareholders Agreement** – An arrangement between shareholders of a company containing their agreement on the regulation of their relationship and on the administration of the company. There will be an overlap with the Articles of Association but it is not, unlike the Articles of Association, subject to public scrutiny.

**Share Dealing** – The buying and selling of shares.

**Shareholders Agreement** – This sets out the terms of an investment (usually venture capital or business angel). It often sets out the duties and obligations of the management team.

**Shareholders' Funds** – Is the total value of funds that belong to the shareholders. Thus it is the sum of the value of issued shares, share revaluation and retained profits.

**Share price** – The price of the company's shares on the stock market.

**Share Premium** – represents the difference on the sale of a new issue of shares to shareholders between the actual price obtained and the nominal share price.

**Share surplus** – Money paid by shareholders when buying newly issued shares, in excess of the face or "par" value of the shares.

**Sliding fee scale** – A management fee that varies over the life of a partnership.

**Small Firms Loan Guarantee Scheme** – The BERR's Small Firms Loan Guarantee Scheme provides a government guarantee for loans by approved lenders. Loans are made to firms or individuals unable to obtain conventional finance because of a lack of track record or security. The guarantee generally covers 70% of the outstanding loan.

**SME** – Small and medium enterprises are defined as employing fewer than 250 employees, an annual turnover of less than €50 million, a balance sheet total of less than €43 million and are less than 25% foreign owned.

**Social Enterprise** – A business whose primary aim is not to maximise profits, but instead operate for the good of a supplier and/or customer group and/or society in general.

**Soft Loan** – Loans that are available without the normal security demands placed on borrowers by clearing banks and other commercial lenders. They usually allow some concessions to the borrower on either security requirements, or on interest rates charged. Payment of little or no interest may be a condition of the loan, and in addition, in some cases borrowers can organise payment holidays.

**Sole Trader** – Where an individual runs a business and all revenue payments are incorporated within the individual's personal finance and tax affairs.

**Spin-out firms** – These are captive or semi-captive firms that gain independence from their parent organisations.

**Staff Costs** – Is the total payment made for staffing during a period. It comprises wages & salaries, social security and pension costs.

**Staff Costs/Sales (%)** – Is the staff costs expressed as a percentage of sales. Therefore it is a measure of labour intensity.

**Stock** – The stock of goods for sale held by a business, often including raw materials and partly finished goods or work (work in progress).

**Stocks/Cost of Sales** – Is the total value of stocks (expressed in days) as a proportion of the cost of sales. Thus it is a measure of the average stock level. The level of stock varies depending on the industry and the efficiency of the business.

**Stockmarket** – The market for the sale and purchase of shares, government bonds, and other securities.

**Strategic investment** – An investment that a corporation makes in a young company that can bring something of value to the corporation itself. The aim may be to gain access to a particular product or technology that the start-up company is developing, or to support young companies that could become customers for the corporation's products. In venture capital rounds, strategic investors are sometimes distinguished from venture capitalists and others who invest primarily with the aim of generating a large return on their investment. Corporate venturing is an example of strategic investing.

**Strategic planning** – Planning related to the long term goals and performance of the business.

**Subsidiary company** – A company, 50% or more of whose shares are owned by the holding company.

**SWOT analysis (Strengths, weaknesses, opportunities and threats)** – The detailed consideration of the internal strengths and weaknesses of the business, and the opportunities and threats it faces from the outside.

**Syndication** – The sharing of deals between two or more investors, normally with one firm serving as the lead investor. Investing together allows venture capitalists to pool resources and share the risk of an investment.

**Supply Chain** – The overall system that covers the flow of material and information from a business to its customer.

## T

**Term sheet** – A summary sheet detailing the terms and conditions of an investment opportunity.

**Tombstone** – When a private equity firm has raised a fund, or it wishes to announce a significant closing, it may choose to advertise the event in the financial press – the ad is known as a tombstone. It normally provides details of how much has been raised, the date of closing and the lead investors.

**Time value of money** – The concept that money in the hand today is worth more than the same amount received in the future because it could be put to work earning compound interest for the period between.

**Trade Creditors** – Is the money currently owed by the company to the suppliers of raw materials and component parts.

**Trade Creditors to Stock** – Is the value of trade creditors expressed as a proportion of the value of stock. Therefore it is a measure of the extent to which the creditors fund stocks.

**Trade Debtors** – Is the total value of money owed to the company by its customers for past sales.

**Trade Finance** – The science that describes the management of money, banking, credit, investments, and assets for international trade transactions

**Trading Period** – Is the period (usually a year) covered by the accounts in question.

**Turnaround** – Turnaround finance is provided to a company that is experiencing severe financial difficulties. The aim is to provide enough capital to bring a company back from the brink of collapse. Turnaround investments can offer spectacular returns to investors but there are drawbacks: the uncertainty involved means that they are high risk and they take time to implement.

## U

**Unit cost** – The total cost of an output divided by the number of units. Units may be physical, e.g. cars or not e.g. passenger miles.

**Unsecured Loan** – A loan where no security collateral is given or charged to the lender.

## V

**Valuation** – The process of determining the current worth of an asset or company. There are many techniques that can be used to determine value, some are subjective and others are objective. Judging the expertise of a company's management would be more of a subjective valuation technique, while calculating intrinsic value based on future earnings would be an objective technique.

**VAT** – (Value Added Tax). Tax applied to the sale of goods and services.

**Venture Capital** – The British Venture Capital Association defines venture capital as "a means of financing the start-up, development, expansion or purchase of a company, whereby the venture capitalist acquires an agreed proportion of the share capital (equity) of the company in return for providing the requisite funding". It is often a term given to early stage investments. Many people use the term venture capital very loosely and what they actually mean is private equity.

**Viability** – The practicality and feasibility of a project which shows a sensible and sound business model

**Vintage year** – The year in which a private equity fund makes its first investment.

## W

**Warranty** – A document signed by shareholders providing legally enforceable assurances about the status of a company, particularly about taxation matters.

**Weighted average cost of capital (WACC)** – The percentage charge levied for money tied up in a company.

**WIP Stocks** – Is the total value of the work-in-progress stocks on hand at the end of the period. Therefore it is the value of stocks that are in the process of being converted into finished product.

**Working Capital** – The cash a company needs to operate on a day-to-day basis, particularly to fund the gap between trade credit and what is required to buy raw materials, work in progress, stock and trade debtors.

**Work in progress** – The value attached to products and services of a business that are under manufacture, but have not yet been invoiced. By its nature, valuation can be subject to controversy

## Z

**Zero-based balance** – A system of budgeting in which historical spending patterns are explicitly ignored, and each budget item is justified *de novo* (from the beginning) at the level proposed for the coming period.