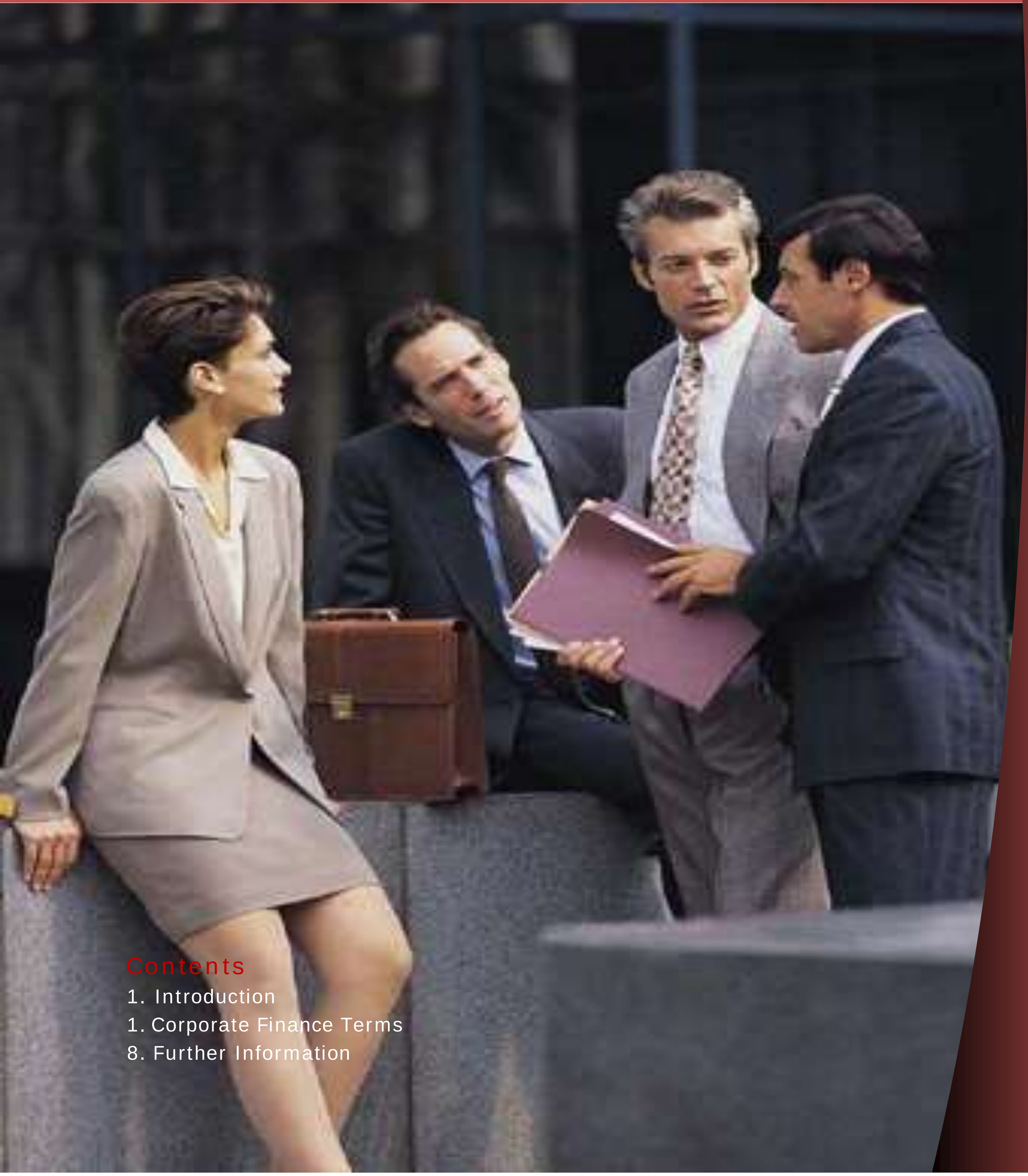
Glossary of Corporate Finance Terms

Expert knowledge means success



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Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

Introduction

We have compiled this glossary of terms to assist you to understand the "jargon" which is used in business and investment. This glossary is limited to Corporate Finance Terms but we publish several other glossaries as well – check our website or call us for details.

The term Corporate Finance can mean any number of things. In practice it is perhaps best simply stated as being:

> *"Anything to do with the finances of a company or business, including raising capital as well as mergers and acquisitions.*

Please contact us if you are thinking of:

- raising additional loan capital for your business;
- submitting an application to bankers for increased facilities;
- needing assistance in the compilation of your business plan;
- raising money on an EIS issue or by a Private Placing Memorandum;
- needing capital to purchase buildings etc;
- requiring advice on the best method of providing finance to purchase equipment and machinery and computers.

Corporate Finance Terms

- Accountants' Report - a report prepared by a registered auditor on a company's historical financial information for publication in a prospectus or similar investment advertisement.
- Acquisitions – this happens when one company takes over another (either "friendly" or "hostile") by purchasing its assets or shares.
- Adequacy of Working Capital - The Stock Exchange requires that in any public document there should be a statement that, in the opinion of the directors, the company has adequate working capital for its present requirements. It is usual for the Reporting Accountants to review the support for this statement, which will include cash flow forecasts for at least twelve months ahead, and to write a Letter of Comfort on the adequacy of the working capital to both the sponsors and the directors of the company.
- Admission and Disclosure Standards - The London Stock Exchange's Admission and Disclosure Standards are for companies admitted or seeking to be admitted to trading.
- Admission (or Admission to Trading) - Admission to trading on the LSE markets for listed securities and 'admitted' and 'traded' shall be construed accordingly. LSE say that, for the avoidance of doubt, this does not include 'when issued dealings'.
- The Alternative Investment Market (AIM) - this is a market similar to the listed market operated by the Stock Exchange but for which the entry requirements are less onerous. Generally, the typical company applying for entry to AIM is smaller than those applying for a full listing and will have a shorter trading record. The principal advantages are that a smaller proportion of the issued capital is required to be held by the public, a three year trading record may be acceptable and less advertising is required.
- Authorisation - the process by which organisations are vetted and licensed to conduct investment business under the Financial Services and Markets Act 2000. Such organisations are known as Authorised Persons.
- Big Bang - 27 October 1986, when the LSE's new regulations took effect and the automated price quotation system was introduced.
- Board Memorandum - a Minute (and supporting papers if appropriate) adopted by the board of directors supporting forecasts, projections, working capital statements, valuations and other financial information.
- Bonds - debt securities issued by governments and companies as a means of raising capita which generally entitle the holder to a fixed-rate of interest during their life and repayment of the amount of the bond at maturity.
- Bonus Issue - the issue by a company of new shares which do not require any payment to be made by the shareholder. This has the effect of making the company's shares more marketable because of the increased number available and the lower market price.
- Board of Directors - groups of individuals who are elected by the shareholders of a company and empowered to carry out certain tasks for the benefit of their shareholders.

- Burn Rate - the rate at which a company (usually a new company) expends capital to finance overhead costs prior to the generation of positive cash flow. This is an important measure because unless the company starts generating positive cash flow, the venture capital funding will be exhausted, potentially forcing the company to close down.
- Business Development Company (or BDC) - a form of publicly traded private equity vehicle used in USA where there has been a group of publicly traded private equity firms that were registered as business development companies (BDCs) under the Investment Company Act of 1940. Typically, BDCs are structured similar to real estate investment trusts (REITs) in that the BDC structure reduces or eliminates corporate taxes. A BDC is a special investment vehicle designed to facilitate capital formation for small companies.
- Call (covered warrant) - a warrant that gives the holder the right, but not the obligation, to buy the underlying at a future date and specified price.
- Call (option) – an option that gives the buyer the right to buy an underlying asset at a future date at a specified price.
- Call (warrant) - a call warrant allows the holder to benefit from a rising market. It rises in value when the underlying asset rises in value.
- Capitalisation Issue - the issue by a company of new shares not requiring any payment to be made by the shareholder. It has the effect of making the company's shares more marketable because of the increased number available and the lower market price. A Capitalisation Issue is the same as a Bonus Issue and Scrip Issue.
- Cash flow - in general terms, money flowing in from sales minus money flowing out for expenses. A positive cash flow is essential for a business to survive.
- Chinese Walls - these are the supposed communication barriers between members or departments of the same financial institution. They are supposed to ensure that sensitive information is not leaked - from, for example, a corporate finance department involved in a takeover to a dealer who would be in a position to buy shares in the companies involved.
- City Code - The City Code on Takeovers and Mergers is published on the authority of the Panel on Takeovers and Mergers, whose members include representatives of a number of financial institutions which are professionally concerned in takeovers and mergers. The City Code sets out the general principles of conduct and lays down certain rules to be observed in takeover and merger transactions. It does not have the force of law but all public limited companies are expected to comply with it.
- Closed-End Fund - these funds have a fixed number of shares, which are listed on the LSE. The market price of the shares is determined by demand and supply factors. Investment trusts are closed-end funds.
- Code of Market Conduct – these are the standards that are to be observed in the UK markets. The Code is issued and enforced by the Financial Services Authority (FSA).
- Combined Code - the benchmark for best practice corporate governance. The code is amended to the Listing Rules.
- Comfort Letter - a Letter of Comfort is the term given to a letter supplied by any of the professional advisors to a company or its sponsors in support of a statement made in a document. Letters of Comfort are not published. They are usually supplied by the Reporting Accountants to the company and to the sponsors in connection with the company's indebtedness and adequacy of working capital.
- Companies Acts – the 1985, 1989 and 2006 Acts, the main pieces of legislation on company law.
- Completion Meeting - this is the meeting at which all documents connected with "going public" are completed, normally including the placing or underwriting agreement.
- Consent Letter - in relation to any document where there is a statement or report purporting to have been made by an expert, written consent will be required from the expert for the document containing the statement or report to be issued. Consent will usually be required from the sponsors and the Reporting Accountants to the issue of the document with the inclusion therein of any letters or reports and references to their names in connection with those letters and reports.
- Consolidations – this occurs when a company reduces the number of shares it has in circulation by consolidating its share capita; for example, shareholders would receive 2, 50p shares for every 1, £1 share held.
- Continuing Obligations - the requirements of The Stock Exchange (as were set out in the Yellow Book) were the obligations a company had to comply with once its securities had been admitted to listing. The General Undertaking covered similar ground for AIM companies. From 1 May 2000,

these were replaced by the FSA Listing Rules.

- Convertibles - corporate securities (usually preferred shares or bonds) that are exchangeable for a set number of another form (usually common share) at a pre-stated price. Convertibles are appropriate for investors who want higher income than is available from common stock, together with greater appreciation potential than regular bonds offer. From the issuer's standpoint, the convertible feature is usually designed as a sweetener, to enhance the marketability of the stock or preferred.
- Covenant - promise in a trust indenture or other formal debt agreement that certain acts will be performed and other refrained from. Designed to protect the lender's interest, covenants cover such matters as working capital, debt-equity ratios, and dividend payments.
- Cumulative Preference Shares - these preference shares accumulate unpaid dividend, which is then paid out when the company next declares it or is able to pay a dividend
- Derogation - a waiver given by the Listing Authority in certain limited circumstances; for example, that inclusion of a particular item in listing particulars is not required.
- Development funding/capital - venture capital provided after a company has become established, to fund an expansion of the business.
- Disclosure Letter - the disclosure letter lessens the Buyer's rights under warranties given by the Vendor by excluding the matter disclosed from the scope of the general warranty. Because it effectively increases the Buyer's risk, the Buyer may not accept all disclosures which the Vendor would like to make to it in the disclosure letter.
- Divestment - the disposal of a business or business segment.
- Drafting Meeting - the Meeting of parties concerned with an issue to draft the prospectus and other documents.
- Earn-out - a formula for calculating sale proceeds to be paid to a disposing management that relates an element of the proceeds to future earnings.
- Enterprise Capital Fund - under the Enterprise Capital Fund (ECF) scheme the Government will match Venture Capital funding pound for pound to help small and medium sized businesses grow.
- Enterprise Investment Scheme (EIS) - successor to the Business Expansion Scheme (BES) aimed at encouraging new equity investment in certain types of unquoted company by offering tax relief on investments by persons unconnected with the company.
- Equity - a shareholding in a company (usually "ordinary shares") other than preference shares etc.
- Exit - the route by which a venture capitalist realises their original investment, usually as a result of flotation or corporate purchase.
- Financial Services and Markets Act 2000 - the regulations that govern the conduct of investment business in the United Kingdom.
- Flotation - the offer or issue for the first time by a company of some or all of its shares to the public to enable them to be dealt with on the Stock Exchange, Alternative Investment Market or the PLUS market.
- Forecast - a statement of management's best expectation of the most likely financial results made for a current, unexpired or future accounting period.
- Full List - The London Stock Exchange is the UK's major stock exchange and the most international of all exchanges world-wide, providing a portfolio of markets enabling companies large and small to raise capital and have their shares traded. The main London market is called the Full List.
- Gearing - broadly, the ratio of debt to equity in a company's capital structure.
- General Undertakings - when a company applies for its shares to be dealt in on the Stock Exchange, its Board is required to adopt the General Undertaking. This is an undertaking that the company will comply with the various rules and regulations which apply to the Market in which its shares are dealt.
- Impact Day - the day upon which the underwriting of an issue takes place and when the prospectus will be made available to the public. There will be some form of announcement to the press and an advertisement or other publicity (usually shortly afterwards) in one or more national newspapers.
- Incorporated - organised as a limited (or unlimited) company (or even an LLP).
- Indebtedness/Indebtedness Date - in any public document it is required that there should be a statement of the company's indebtedness at the most recent practicable date (generally no later than twenty eight days before the date of the document). Indebtedness, for the purpose of this disclosure, includes borrowings, bank overdrafts, liabilities under acceptances or acceptance credits, mortgages, charges, hire purchase, commitments,

finance leases, guarantees or other material contingent liabilities.

- Institutional investor - an investor investing other than in a private capacity - normally a financial institution such as an insurance company.
- Introduction - an Introduction is a method of application for listing where marketing arrangements are not required because the securities to be listed are already of such an amount that that their adequate marketability when listed can be assumed.
- Investigation - the analysis of the operating and/or financial aspects of a business - the objective being to produce a report that will help or support the decision-making process.
- IRR - a basis by which to measure investor returns, being effectively the compounded annual rate of return on their investment, including interest, dividends and realisation profits. It is used, for example, by venture capitalists to measure achievement and in such cases the IRR is greatly affected by the timing of exit.
- IPO (Initial public offering) - the first sale of privately owned equity (stock or shares) in a company via the issue of shares to the public and other investing institutions. In other words an IPO is the first sale of stock by a private company to the public. IPOs typically involve small, young companies raising capital to finance growth. For investors IPO's can be risky as it is difficult to predict the value of the stock (shares) when they open for trading. An IPO is effectively 'going public' or 'taking a company public'.
- Issuing House - an Issuing House is usually a merchant bank, stockbroker or other financial institution which sponsors an issue (see also sponsor).
- Leveraged buy-out - similar to a management buy-out or buy-in but without the same degree of direct equity participation by the managers. The term 'leverage' is another name for gearing and is used to indicate the substantial levels of borrowings taken on by the acquisition vehicle to finance the acquisition, which is typically secured on the assets of the business being purchased.
- Listing - a Listing is the admission of securities to the Official List of securities, which are dealt in on the Stock Exchange.
- Listing Particulars - a document is required to be published as a condition of the admission of securities to listing. Its content was prescribed by the Yellow Book and under the Stock Exchange (Listing) Regulations but, from 1 May 2000, the Listing Requirements are prescribed by the FSA. An offer of securities by means of a document containing Listing Particulars is deemed to satisfy the Companies Act requirements for the contents of a prospectus.
- Listing Rules (or FSA Listing Rules) – the rules that which set out the conditions to be satisfied in order for securities to be admitted to the Official List. With effect from 1 May 2000, the London Stock Exchange's Listing Rules (commonly known as the "Yellow Book") ceased to be effective and have been replaced by the FSA Listing Rules. The London Stock Exchange has published Admission and Disclosure Standards (the "Standards") which set out the conditions to be satisfied in order for securities to be admitted to trading on its market for listed securities.
- Loan-to-Own (or Distressed-Debt Strategy/Rescue Financing) – a strategy used by private equity and other investors to purchase companies as an alternative to conventional asset, stock or merger transactions. In applying these strategies, creditors use their debt positions to take ownership of troubled companies which agree with their lenders and shareholders to dramatically strengthen their balance sheet by swapping the majority of their debt for equity. It provides an opportunity for investors to take control of a company without buying it outright, providing capital to a business that needs money to continue operating. The strategy can also be applied by Hedge Funds and Private Equity investors to acquire debt, and sometimes certain amounts of equity or management control, such as voting power or board seats, from a lender of a distressed company.
- Long Form Report - this is a report which is usually prepared by the Reporting Accountants after a detailed investigation into the company's affairs in order to provide the sponsors and other professional advisors with detailed information on the company and its affairs.
- Marketing - the sale of new or existing securities to public investors.
- MBI - it stands for Management Buy-in, the purchase of a business by an outside team of managers who have found financial backers and plan to manage the business actively themselves.
- MBO - it stands for Management Buy-Out, the purchase of a company by its management.
- Merger - the agreed joining together of two companies, usually in the same industry, to provide a new, combined,

entity with control still reflected in the ownership shares of the original companies.

- Mezzanine finance - a form of finance falling between equity and debt. It is a flexible form of funding, typically used in a management buy-out to achieve the desired overall risk/return profile for investors. Frequently unsecured, it usually bears interest at a higher rate than secured loans and often carries an option to give the lender a stake in the equity.
- Model Code - the Model Code is a set of basic principles and rules drawn up by the Stock Exchange which provide guidance for directors of companies as to how they should act in regard to the buying and selling of securities in the companies of which they are directors.
- NewCo - a newly formed company set up as an acquisition vehicle, for example, in a management buy-out.
- Offer for Sale/Offer for Sale by Tender - one of the methods by which securities may be brought to the Stock Exchange. It is an offer to the public by a sponsor to sell securities already in issue or for which the sponsor has agreed to subscribe. The offer may be at a fixed price or may invite tenders at different prices (subject to a minimum).
- Offer for Subscription - this is an offer by a company of its own securities to the public for subscription.
- Operational Gearing – this refers to the extent to which the firm's total costs are fixed. The higher the proportion of fixed costs relative to variable operating costs, the higher the operational gearing. This results in greater business risk. A retailer has high fixed costs relative to variable costs, so has a lot of business risk. If a business has no operational gearing, then operating profit would rise at the same rate as sales growth (assuming nothing else changed).
- Pathfinder Prospectus - in a new issue of shares, a detailed report on the company is prepared and made available to potential investors a few days before the issue price is announced.
- Pink Form - a preferential application form for shares (normally printed on pink paper) issued to shareholders and/or employees of a company, which will be treated preferentially in the allocation of those shares. The London Stock Exchange allows companies offering shares to the public to set aside up to 10% of the issue for applications from employees and, where a parent company is floating off a subsidiary, from shareholders of the parent company.
- Placing - the sale of (or obtaining subscription for) securities by a sponsor through the market and to their own clients. This is a concession which, in general, is only allowed where there is not likely to be a significant demand for securities.
- Profit Forecast - an estimate made by the directors of profits, which they expect the company to achieve in the current or subsequent accounting period. This will be accompanied by a list of the principal assumptions used by the directors in making the forecast and will be supported by letters issued by the Auditors and/or Reporting Accountants and the Issuing House.
- Prospectus - a document that deals with offer for sale, placing or subscription which is published or circulated. Its contents are governed by the requirements of the Yellow Book and by the provisions of the Companies Act 1985.
- Public Limited Company - a public limited company wishing to commence trading is required, inter alia, to have an allotted share capital of a nominal value of not less than £50,000 (of which at least 25% must be paid up), and to have been registered as such.
- Quotations Department - the Quotations Department of the Stock Exchange provides advice and interpretation of the rules and regulations governing an entry to the Official List of the Stock Exchange or the Alternative Investment Market. All prospectuses for a flotation on these two markets are required to be approved by the Quotations Department, which will ensure that the Stock Exchange rules requiring sufficient disclosure in the document of all matters which are relevant to an investment decision are observed. The Quotations Department also monitors the subsequent compliance with the rules and regulations of the Stock Exchange.
- Ratchet - an incentive arrangement whereby a number of trigger points for future profits are set such that the managers get a bigger share of the equity if the company performs well and a lesser share if it performs badly.
- Reporting Accountants - the firm of Accountants (Registered Auditors) who report on the financial information contained in the prospectus and who deal with other accounting matters connected with the Issue. The Reporting Accountants are often the company's own Auditors, although this depends primarily on their experience of new issue and Stock Exchange work.
- Second Lien Financing - one of the biggest financing trends in recent years has been the move away from unsecured mezzanine credit to debt secured by a *second* priority security interest on all of the company's assets. Much of this "second lien" debt is coming from hedge funds and other

private equity funds, although traditional lenders have also become active in the market. Second Lien Financing is a simple loan with a subordinated security (finance) structure or no security at all (unsecured debt), meaning that the borrower grants another provider of a finance instrument (such as a senior loan) priority over settlement of owed monies in case of an event of default. The arrangement fee and interest of a second lien financing package is higher than those of the senior loan of the same borrower because of increased risk for the lender.

- Securitisation (or asset securitisation) – essentially a method of raising debt finance. It involves the sale of income generating financial assets (such as loans, trade receivables and leases) by a company to a special purpose vehicle (SPV). The economic interest in the financial assets is transferred to investors via the securitisation process as part of which the assets are transferred to a special purpose vehicle that is normally separated from the borrower and can thus obtain a better rating from credit rating agencies, than the borrower could. The assets concerned (loans, trade receivables and leases etc) are used as collateral backing for the issue of securities to third party investors.
- Seed Capital - In particular, seed capital is the term given to providing venture capital finance for the early stage development of ideas into products.
- Short Form Report - a report prepared by Reporting Accountants for inclusion in a prospectus (and certain other circulars to shareholders) setting out the information which is required to be published in conformity with the Companies Acts.
- Sponsor - the role of the Sponsor is to co-ordinate events and activities of other advisors involved in preparing a prospectus. He is also responsible for ensuring that the contents of the prospectus give a fair representation of the company and for advising on the appropriate market, the timing of the issue, arranging underwriting and other such matters.
- Statements of Adjustments - the Reporting Accountants are required to provide a written statement (which will be available for public inspection) setting out the adjustments made by them to the previously published audited accounts in arriving at the figures shown in the Accountants' Short Form Report.
- Sub-Underwriting - the Sponsor to the issue, which will normally underwrite its terms, may spread its financial risk by sub-underwriting a proportion of its total commitment with other financial institutions.
- Takeover Panel - the Panel on Takeovers and Mergers is a body representative of the financial organisations that are responsible for the preparation of the City Code. The duties of the Takeover Panel are to administer and enforce the rules and regulations embodied in the City Code. It can be consulted at any time to give rulings on points of interpretation of the City Code or for confidential consultation during a takeover or merger transaction.
- Tax Clearances - when a company raises new capital or makes any of its existing shares available to the public there may be taxation consequences. Accordingly, it will often be necessary to obtain clearances from HMRC that certain assessments to tax will not be made as a result of a transaction.
- Tender - in some circumstances the sponsors to an issue may advise a company to offer its shares for tender rather than making an offer for sale at a fixed price. This method (which indicates the minimum price and allows for applications at or above that price) is used where it is particularly difficult to indicate a price for a new issue which is fair to both purchaser and vendor. It can be used where there is no comparable listed company which can indicate a price for the shares, or where it is anticipated that there will be overwhelming demand for the shares.
- The Stock Exchange - the Stock Exchange (or London Stock Exchange) is the principal market place for trading in securities of companies, domestic or foreign, and in the direct or indirect debt obligations of governments. All applications for listing are required to be submitted by a member firm of LSE and approval for a listing is given by its Council.
- Underwriting - when securities are being offered to, or placed with, the public it is normal for the offer or placing to be underwritten. The Underwriter or Underwriters will usually be major financial institutions who undertake to acquire shares to the extent that the public does not take them up. In this context an underwriting agreement will be drawn up between the vendors of shares and the Underwriters (normally the Sponsor will underwrite the risk) and underwriting commission will be payable.
- Underwriting Agreement (Placing Agreement) - the agreement between the Underwriter, the directors, vendors of shares and the company that deals with the underwriting (or placing). This agreement normally contains warranties by the company, its directors and the

vendors as to the information on the company disclosed in the prospectus and more generally, and indemnities to the company and the sponsor by the directors and the vendors in relation to the company's tax position.

- Underwriting Commission - commission paid to the Underwriter for entering into the underwriting agreement, normally at the rate of 2 per cent for an offer of sale (3 to 4 per cent in the case of a placing) out of which the underwriting will pay commission to the stockbrokers of 0.25 per cent and commission of 1.25 per cent to any sub underwriters.
- Venture capital - the concept of adding value to investments by participating in the management and offering advice. A wider definition would be risk investment in un-quoted companies with high growth potential. Venture capital can be broadly subdivided into seed or start up capital (used to bring a research idea to the development stage), second round finance for young companies (used to expand the range of products) and development capital for established companies (used to develop an alternative product or expand through acquisition).
- Verification / Verification Notes - the procedures adopted to confirm the accuracy of statements made in the Listing Particulars/prospectus and to ensure that the view it presents of the company is fair and not misleading. Such procedures are designed to ensure that the directors of the company have discharged their responsibilities in issuing the listing particulars/prospectus (and ultimately to protect them), and normally evidenced by the solicitors to the issue requiring detailed notes or evidence to support all material statements.
- Warrant - type of security, usually issued together with a bond or preferred stock that entitles the holder to buy a proportionate amount of common stock at a specified price
- Working Capital - this is current assets less current liabilities, representing the required funds continually circulating, to finance stock, debtors, and work in progress.
- Yellow Book - the Yellow Book was the book entitled "Admission of Securities to Listing" issued by the London Stock Exchange. It set out the rules governing the admission of securities to listing together with notes for guidance on various aspects of the rules. This changed on 1 May 2000 (see Listing Rules).
- Yield – this is the return earned on an investment taking into account the annual income and its present capital value. There are a number of different types of yield, and in some cases different methods of calculating each type.
- Yield to Maturity (YTM) - this is the rate of return anticipated on a bond if it is held until the maturity date.

Further Information

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

Important Notice

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