M&A GLOSSARY OF TERMS

A

Accretive: growing in size by external addition. Often used to refer to an acquisition which is expected to increase earnings per share.

Accrual: an accounting procedure that records (recognizes) income or expense on a company's financial statement at the time the income or liability event occurs (i.e., the exchange of goods or services) rather than when income is received or expenses are paid in cash.

Accumulated Dividend: a dividend that a company owes to an investor but that is not paid currently. Dividends frequently accumulate for a fixed period (e.g., two years) to permit a company to retain cash to grow the business. Alternatively, dividends may be payable in full only in the event of a liquidity event (e.g., sale, IPO, or redemption) and accumulate until such time. Accumulated dividends are reflected on a company's balance sheet. After-Tax Operating Income: see Net operating profit after taxes.

Alternative Asset Class: a class of investments that includes private equity, real estate, and oil and gas, but excludes publicly traded securities. Pension plans, college endowments and other relatively large institutional investors typically allocate a certain percentage of their investments to alternative assets with an objective to diversify their portfolios.

All or None Offering: a securities offering that does not close unless all, but not less than all, of the securities offered are actually purchased. This contrasts with a pure best efforts offering, in which no guaranteed minimum sale of securities must occur before the offering closes.

Angel: a wealthy individual that invests in companies in relatively early stages of development. Usually angels invest less than $1 million per startup. The typical angel-financed startup is in concept or product development phase.

Anti-Dilution: contractual provisions that protect an investor from certain consequences when a dilution event occurs, such as a subsequent sale by the company of additional equity securities. Generally, such contractual provisions provide either price protection or maintenance of proportionate ownership protection. The most frequent forms of antidilution provisions are full ratchet or weighted average.

Audited Statement: a financial statement that has been examined by an independent auditor who has expressed an opinion on the financial statement based on an audit. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Audits are conducted in accordance with generally accepted auditing standards and are designed to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audited statement represents a higher level of accountant involvement than a review statement or a compilation statement. Outside investors and banks frequently require companies to obtain audited statements as a condition to an investment or a loan.

B

Balloon Payment: a relatively large principal payment due at a specific time as required by a lender.

Basis Point ("bp"): one one-hundredth (1/100) of a percentage unit. For example, 50 basis points equals one half of one percent. Banks quote variable loan rates in terms of an index plus a margin and the margin is often described in basis points, such as LIBOR plus 400 basis points or, as the experts say, "beeps".

Beeps: see Basis point or bp.

Best Efforts Offering: an offering in which the underwriter has no obligation to purchase any securities not sold. The underwriter's commitment is limited to using its best efforts to sell as many securities as possible at the price agreed to between the company and the underwriter. See mini/maxi offering.

Beta: a measure of volatility of a public stock relative to an index or a composite of all stocks in a market or geographical region. A beta of more than one indicates the stock has higher volatility than the index (or composite) and a beta of one indicates volatility equivalent to the index (or composite). For example, the price of a stock with a beta of 1.5 will change by 1.5% if the index value changes by 1%. Typically, the S&P500 index is used in calculating the beta of a stock.

Beta Product: a product that is being tested by potential customers prior to being formally launched into the marketplace.

Blank Check Preferred Stock: shares of preferred stock that have been authorized (but not issued) by a company, but the specific rights and preferences of which have not yet been fixed. The board of directors can establish the specific rights and preferences of one or more offerings of blank check preferred stock, including liquidation preferences, dividend rates, and voting rights, without receiving additional stockholder approval, provided that the rights and preferences are within the limits established in the company's certificate of incorporation or by agreement. The existence of blank check preferred stock permits a company to structure, offer, and sell a financing quickly and privately because the board of directors can negotiate the terms of a new issue of securities directly with the purchaser (or purchaser's agent) without additional stockholder authorization.

Blue Sky Laws: state securities laws. A company selling securities must comply with the securities laws of all states in which the company offers or sells securities.

Blow-out round: see Cram-down round.

Board of Directors: the individuals whose collective legal responsibility it is to manage the business and operations of a corporation. As a practical matter, most boards of directors provide oversight authority over management who run the day-to-day operations of a company. The certificate of incorporation and bylaws establish the number of directors for each company, either a fixed number (usually an odd number so that voting deadlocks don't occur) or a range (e.g., five to nine, as determined by the stockholders).

Boat Anchor: a person, project or activity that hinders the growth of a company.

Book: see Private placement memorandum. Book Runner: the lead bank that manages the transaction process for an equity or debt financing, including documentation, syndication, pricing, allocation and closing.

Book Value: the book value of a company is the value of the common stock (total assets minus liabilities minus preferred stock minus intangible assets). The book value of an asset of a company is typically based on its original cost minus accumulated depreciation.

Bootstrapping: the actions of a startup to minimize expenses and build cash flow, thereby reducing or eliminating the need for outside investors.

Bp – see Basis point.

Bridge Financing: temporary funding that will eventually be replaced by permanent capital from equity investors or debt lenders. In venture capital, a bridge is usually a short term note (6 to 12 months) that converts to preferred stock. Typically, the bridge lender has the right to convert the note to preferred stock at a price that is a 20% discount from the price of the preferred stock in the next financing round. See Wipeout Bridge and Hamburger Helper Bridge.

Broad-Based Weighted Average Ratchet: a type of anti-dilution mechanism. A weighted average ratchet adjusts downward the price per share of the preferred stock of investor A due to the issuance of new preferred shares to new investor B at a price lower than the price investor A originally received. Investor A's preferred stock is repriced to a weighted average of investor A's price and investor B's price. A broad-based ratchet uses all common stock outstanding on a fully diluted basis (including all convertible securities, warrants and options) in the denominator of the formula for determining the new weighted average price. See Narrowbased weighted average ratchet.

Bullet Payment: a payment of all principal due at a time specified by a bank or a bond issuer.

Burn Rate: the rate at which a startup with little or no revenue uses available cash to cover expenses. Usually expressed on a monthly or weekly basis.

Business Development Company (BDC): a publicly traded company that invests in private companies and is required by law to provide meaningful support and assistance to its portfolio companies.

Business Plan: a document that describes a new concept for a business opportunity. A business plan typically includes the following sections: executive summary, market need, solution, technology, competition, marketing, management, operations and financials.

Bylaws: a company's charter document that governs basic corporate activities, internal procedures, and certain of the substantive (as opposed to procedural) rights relating to stockholders' meetings and voting rights, meetings of the board of directors and their authority, election and duties of officers, indemnification, and other matters.

Buyout: a sector of the private equity industry. Also, the purchase of a controlling interest of a company by an outside investor (in a leveraged buyout) or a management team (in a management buyout).

Buy-Sell Agreement: a contract that sets forth the conditions under which a shareholder must first offer his or her shares for sale to the other shareholders before being allowed to sell to entities outside the company.

C

C Corporation: an ownership structure that allows any number of individuals or companies to own shares. A C corporation is a stand-alone legal entity so it offers some protection to its owners, managers and investors from liability resulting from its actions. A C Corporation is a company whose federal income tax status is subject to **Subchapter C of the Internal Revenue Code**. C corporations owe federal income taxes based on the income of the company as an entity, and the taxes are paid by the company. Unlike the stockholders of an S corporation, the stockholders of a C corporation do not pay taxes on the corporation's income. See S corporation.

Call Date: when a bond issuer has the right to retire part or all of a bond issuance at a specific price.

Call Premium: the premium above par value that an issuer is willing to pay as part of the redemption of a bond issue prior to maturity.

Call Price: the price an issuer agrees to pay to bondholders to redeem all or part of a bond issuance.

Call Rights: the ability of the call right holder to purchase securities either at a specified price or upon specified terms and conditions, and pursuant to an agreed pricing formula. A call is the opposite of a put. (See put rights.)

Call Protection: a provision in the terms of a bond specifying the period of time during which the bond cannot be called by the issuer.

Capital Asset Pricing Model (CAPM): a method of estimating the cost of equity capital of a company. The cost of equity capital is equal to the return of a risk-free investment plus a premium that reflects the risk of the company's equity.

Capital Call: when a private equity fund manager (usually a "general partner" in a partnership) requests that an investor in the fund (a "limited partner") provide additional capital. Usually a limited partner will agree to a maximum investment amount and the general partner will make a series of capital calls over time to the limited partner as opportunities arise to finance startups and buyouts.

Capitalization Rate: the discount rate used to determine the present value of an infinitely lived asset.

Capitalization Table: a table showing the owners of a company's shares and their ownership percentages as well as the debt holders. It also lists the forms of ownership, such as common stock, preferred stock, warrants, options, senior debt, and subordinated debt.

Capital Gains: a tax classification of investment earnings resulting from the purchase and sale of assets. Typically, an investor prefers that investment earnings be classified as long term capital gains (held for a year or longer), which are taxed at a lower rate than ordinary income.

Capital Stock: a description of stock that applies when there is only one class of shares. This class is known as “common stock”.
Capped Participating Preferred Stock: preferred stock whose participating feature is limited so that an investor cannot receive more than a specified amount. See Participating preferred stock.

Carried Interest: A share in the profits of a private equity fund. Typically, a fund must return the capital given to it by limited partners plus any preferential rate of return before the general partner can share in the profits of the fund. The general partner will then receive a 20% carried interest, although some successful firms receive 25%-30%. Also known as “carry” or “promote.”

Carve-out: The partial divestiture of a business unit. A company undertaking a carve-out is not selling a business unit outright, and may instead sell an equity stake in that business or spin the business off on its own while retaining an equity stake itself. A carve-out allows a company to capitalize on a business unit that may not be part of its core operations.

Catch-Up: a clause in the agreement between the general partner and the limited partners of a private equity fund. Once the limited partners have received a certain portion of their expected return, the general partner can then receive a majority of profits until the previously agreed upon profit split is reached.

Certificate of Incorporation: a company's basic organizational document, filed with the secretary of state in the state of incorporation. The certificate generally reflects the name, location, and purpose of a company; the number, classification, rights, and preferences of a company's capital stock; and voting authority of the directors with respect to related party transactions and redemptions. In some states, the certificate of incorporation is referred to as the articles of incorporation.

Change of Control Bonus: a bonus of cash or stock given by private equity investors to members of a management group if they successfully negotiate a sale of the company for a price greater than a specified amount.

Class: the division of a company's capital stock into different groups, with each separate class (i.e. group) having specified rights designated in the company's certificate of incorporation. Classes of capital stock may also be divided into series.

Clawback: a clause in the agreement between the general partner and the limited partners of a private equity fund. The clawback gives limited partners the right to reclaim a portion of disbursements to a general partner for profitable investments based on significant losses from later investments in a portfolio.

Closing: the conclusion of a financing round whereby all necessary legal documents are signed and capital has been transferred.

Club Deal: see Co-investment.

Co-investment: either a) the right of a limited partner to invest with a general partner in portfolio companies, or b) the act of investing by two or more entities in the same target company also known as a Club deal.

Cold Comfort Letter: a letter provided by a company's independent accountants confirming financial information in the offering memorandum and detailing the procedures followed by the accountants at the request of the underwriter or placement agent.

Collateral: security given by a borrower to a lender in connection with a loan to insure that the lender is repaid. Lenders frequently accept collateral in tangible assets such as inventory, accounts receivable, real property, or buildings and less commonly take intangible assets such as patents or trademarks as collateral. In the event that the borrower cannot repay the loan when due, or for other reasons that may constitute an event of default, the lender, after complying with the loan agreement and applicable law, has the right to take possession of the Collateral, sell it, and apply the net proceeds (i.e., the cash received after payment of costs of sale) to the loan repayment.

Come Along Right: See co-sale right.

Commitment: an obligation, typically the maximum amount that a limited partner agrees to invest in a fund.

Common Stock: a type of security representing ownership rights in a company. Usually, company founders, management and employees own common stock while investors own preferred stock. In the event of a liquidation of the company, the claims of secured and unsecured creditors, bondholders and preferred stockholders take precedence over common stockholders. See Preferred stock.

Comparable: a publicly traded company with similar characteristics to a private company that is being valued. For example, a telecommunications equipment manufacturer whose market value is 2 times revenues can be used to estimate the value of a similar and relatively new company with a new product in the same industry. See Liquidity discount.

Compilation Statement: the minimum level of financial statement preparation by an accountant. A compilation statement verifies only the mathematical accuracy of the financial information presented to the accountant by management. A compilation financial statement involves no testing of receivables, inventory, or other assets or verification by the accountant preparing the compilation statement. Compilation statements lack footnotes and other disclosures found in an audited statement or review statement.

Confidentiality and Non-Disclosure Agreement (NDA): a document providing protection for parties that exchange confidential business information in the process of a transaction or other discussions with potential partners, vendors, investors and customers. While terms may vary with different NDA forms, the intent is to allow for sharing of business information that will demonstrate the value of a target or the qualifications of a buyer without fear of the information being used to harm the other party.
Consent: permission from different individuals or entities. A company must obtain the consent (or waiver) from a specified percentage of those stockholders who are contractually protected by a covenant to take certain actions otherwise restricted by covenant. In a different context, the company's accountants consent to the inclusion of their audit reports on prior years' financial statements in an offering memorandum or prospectus.

Control: the authority of an individual or entity that owns more than 50% of equity in a company or owns the largest block of shares compared to other shareholders.

Consolidation: see Rollup.

Conversion: the right of an investor or lender to force a company to replace the investor's preferred shares or the lender's debt with common shares at a preset conversion ratio. A conversion feature was first used in railroad bonds in the 1800's.

Conversion Price: the price at which a convertible security can be converted (exchanged) into another security. If a $100 convertible note has a conversion price of $5, then the holder of the convertible note can exchange the note for 20 shares of common stock (i.e., the amount of the debt divided by the conversion price). Conversion prices are subject to change to protect an investor based on the application of antidilution clauses. If the conversion price is decreased to $4 from $5 as a result of applying an antidilution clause, then the holder of the $100 convertible note can exchange the note for 25 shares of common stock (i.e., the amount of the debt divided by the reduced conversion price).

Convertible Debt: debt that can be converted from debt to equity, usually at the option of the debt holder. Convertible debt provides the debt holder with preferred protection as a creditor of a company, but with the potential to convert the debt to common stock if the value of the common stock on conversion exceeds the principal and interest owed by the company to the debt holder. Convertible debt is conceptually similar to convertible preferred stock, but since the convertible debt is a debt security rather than an equity security, the convertible debt would be repaid prior to preferred stock in the event of a sale or liquidation.

Convertible Preferred Stock: a form of preferred stock that grants the holder the right (but not the obligation) to convert the preferred stock into common stock. Convertible preferred stock generally has a liquidation preference in an amount equal to the original purchase price plus any accumulated dividends. Dividends on convertible preferred stock may be paid currently or accumulated depending on the particular company. Under certain circumstances, generally on a qualifying IPO, Convertible preferred stock automatically converts to common stock for several reasons. First, underwriters prefer that a public company not have more than one class of stock so that all of the company's stockholders are on equal standing. Second, when a company goes public, the preferred stockholder has achieved a major private equity investment goal of liquidity and no longer needs the economic and contractual protection provided by preferred stock.

Convertible Security: securities that permit the holder to acquire an equity interest by converting (i.e., exchanging) the original security into common stock. Common examples of convertible securities are options, warrants, convertible preferred stock, or convertible debt.
Most convertible securities are convertible at the election of the holder. For holders of convertible preferred stock, the conversion right permits the preferred stockholder to choose between receiving a liquidation preference on the preferred stock and converting the preferred stock to common stock. Conversion only occurs if the value of the common stock obtained on conversion exceeds the liquidation preference.

Co-Sale Right: an investor's right to sell the investor's own securities at the same time, at the same price, and on the same terms and conditions as another stockholder (generally the controlling stockholder or key management). These rights are also referred to as tag along rights or come along rights and usually are eliminated in connection with a qualifying IPO.

Cost of Capital: see Weighted average cost of capital.

Cost of Revenue: the expenses generated by the core operations of a company.

Covenants: a legal promise to do or not do a certain thing. For example, in a financing arrangement, company management may agree to a negative covenant, whereby it promises not to incur additional debt. The penalties for violation of a covenant may vary from repairing the mistake to losing control of the company.

Coverage Ratio: describes a company's ability to pay debt from cash flow or profits. Typical measures are EBITDA/Interest, (EBITDA minus Capital Expenditures)/Interest, and EBIT/Interest.

CPA: a certified public accountant.

Cram Down Round: a financing event upon which new investors with substantial capital are able to demand and receive contractual terms that effectively cause the issuance of sufficient new shares by the startup company to significantly reduce ("dilute") the ownership percentage of previous investors.

Cumulative Dividends: the owner of preferred stock with cumulative dividends has the right to receive accrued (previously unpaid) dividends in full before dividends are paid to any other classes of stock.

Cumulative Voting: the right of a stockholder to vote jointly in the election of directors and to cast all the stockholder's aggregate votes for one or more directors rather than casting the same number of votes for each director. Thus, if a stockholder owns 10 shares, and three directors are being elected, the stockholder has an aggregate of 30 votes (i.e., the number of shares times the number of directors being elected). The stockholder can cumulate votes and cast all 30 votes in favor of one director, or split the 30 votes among the three directors at the stockholder's discretion. The right to cumulative voting is frequently eliminated in a company's certificate of incorporation. In a company without cumulative voting, the same stockholder would only have the right to cast 10 votes for or against the election of each director. Cumulative voting increases the ability of a minority investor to obtain representation on the board of directors.

Current Ratio: the ratio of current assets to current liabilities.

D

Data Room: a specific location where potential buyers / investors can review confidential information about a target company. This information may include detailed financial statements, client contracts, intellectual property, property leases, and compensation agreements. Usually done via internet data rooms for larger transactions.

Deal Flow: a measure of the number of potential investments that a fund reviews in any given period.

Debt: an amount owed by someone (i.e., the debtor) to another (i.e., the creditor). Also referred to as a liability. Debt owed by a company to a financial institution or an investor in a transaction in which the company does not provide collateral to the lender is unsecured debt. When the debt is secured by collateral, the debt is referred to as secured debt. Common forms of debt securities are notes or bonds. (See subordinated debt.)

Debt Service: the ratio of a loan payment amount to available cash flow earned during a specific period. Typically lenders insist that a company maintain a certain debt service ratio or else risk penalties such as having to pay off the loan immediately.

Demand Registration Rights: an investor's contractual right to demand that the issuer register specified restricted securities with the SEC and the state securities agencies so that the restricted securities become registered and freely tradeable. Typically, registration costs are paid by the company. Demand registration rights force a company to file a registration statement permitting the holder to conduct a public offering of the holder's securities. Generally, demand registration rights are available only after a company's IPO to facilitate the sale of restricted securities that cannot otherwise be sold without registration.

Default: a company's failure to comply with the terms and conditions of a financing arrangement.

Defined Benefit Plan: a company retirement plan in which both the employee and the employer contribute to the plan. Typically the plan is based on the employee's salary and number of years worked. Fixed benefits are outlined when the employee retires. The employer bears the investment risk and is committed to providing the benefits to the employee. Defined benefit plan managers can invest in private equity funds.

Defined Contribution Plan: a company retirement plan in which the employee elects to contribute some portion of his or her salary into a retirement plan, such as a 401(k) or 403(b). With this type of plan, the employee bears the investment risk. The benefits depend solely on the amount of money made from investing the employee's contributions. Defined contribution plan capital cannot be invested in private equity funds.

Demand Rights: a type of registration right. Demand rights give an investor the right to force a startup to register its shares with the SEC and prepare for a public sale of stock (IPO).

Dilution: has two common meanings. From an accounting perspective, dilution is the net difference between the purchase price per share paid by a new investor to buy a security from the company and the tangible book value per share of the company prior to the offering. From an investor perspective, dilution is also the change to an investor's percentage ownership in a company that results from a subsequent issuance of additional equity securities.

Dilution Protection: see Anti-dilution and Ratchet.

Direct Costs: see Cost of revenue.

Directors: the individuals whose legal responsibility is to manage the business and operations of a company. (See board of directors.)

Disbursement: an investment by a fund in a company.

Discount Rate: the interest rate used to determine the present value of a series of future cash flows.

Discounted Cash Flow (DCF): a valuation methodology whereby the present value of all future cash flows expected from a company is calculated.

Distressed Debt: the bonds of a company that is either in or approaching bankruptcy. Some private equity funds specialize in purchasing such debt at deep discounts with the expectation of exerting influence in the restructuring of the company and then selling the debt once the company has meaningfully recovered.

Distribution: the transfer of cash or securities to a limited partner resulting from the sale, liquidation or IPO of one or more portfolio companies in which a general partner chose to invest.

Dividend: the distribution of earnings from a company to its stockholders, either in cash or stock. Cash dividends are usually ordinary income to the recipient and are not deductible by the company. Dividends to holders of preferred stock are calculated at a contractually agreed rate and may be paid currently or may accumulate (see accumulated dividend). Dividends to holders of common stock vary based on the earnings, cash needs, and prospects for the company.

Down Round: a round of financing whereby the valuation of the company is lower than the value determined by investors in an earlier round.

Drag-Along Rights: the right of a security holder to force another security holder to sell his or her stock (usually in connection with a sale of the company), provided that the person being dragged receives the same price, terms, and conditions for the security being sold as the person exercising the drag along rights. Drag along rights facilitate the ability to sell 100 percent of a company's securities to a buyer, thereby eliminating any minority investors. Many buyers are only willing to buy a company that the buyer can completely own. Drag along rights are eliminated in connection with an IPO.

Drive-by VC: a venture capitalist that only appears during board meetings of a portfolio company and rarely offers advice to management. Due Diligence: the responsibility of entities or individuals involved in a securities offering to investigate the information in the offering memorandum or prospectus to provide a reasonable basis for believing that the information contained is true and that the offering documents do not omit to state a material fact.

Dutch Auction: a method of conducting an IPO whereby newly issued shares of stock are committed to the highest bidder, then, if any shares remain, to the next highest bidder, and so on until all the shares are committed. Note that the price per share paid by all buyers is the price commitment of the buyer of the last share.

E

Early Stage: the state of a company after the seed (formation) stage but before middle stage (generating revenues). Typically, a company in early stage will have a core management team and a proven concept or product, but no positive cash flow.

Earnings Before Interest and Taxes (EBIT): a measurement of the operating profit of a company. One possible valuation methodology is based on a comparison of private and public companies' value as a multiple of EBIT.

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA): a measurement of the cash flow of a company. One possible valuation methodology is based on a comparison of private and public companies' value as a multiple of EBITDA.

Earn Out: an arrangement in which sellers of a business receive additional future payments, usually based on financial performance metrics such as revenue or net income.

Elevator pitch: a concise presentation, lasting only a few minutes (an elevator ride), by an entrepreneur to a potential investor about an investment opportunity.

Employee Stock Ownership Program (ESOP): a plan established by a company to reserve shares for long-term incentive compensation for employees.

Enterprise Value (EV): the sum of the market values of the common stock and long term debt of a company, minus cash.

Equity: has three meanings. Equity is the opposite of debt and represents the residual economic ownership or claims in a company after the claims of all creditors have been satisfied. Common stock and preferred stock are each classified as an equity security. From an accounting perspective, equity (or stockholders' equity) is a company's net worth (i.e., the difference between a company's assets and its liabilities). From a corporate finance perspective, the equity value of a company is the total value of its capital stock (i.e., the sum of the value of all classes of common stock and preferred stock).

Event of Default: the failure of a company to satisfy its contractual agreements and covenants in loan agreements and mezzanine securities documents. Common events of default include failure to pay principal, interest, or dividends when due; violation of the company's representations, warranties, or covenants; or becoming insolvent. Securities documents provide that upon an event of default, investors have specified remedies that can be exercised, including increased interest rates or dividends, the ability to take possession of collateral, or, in extreme cases, the ability to control the company through electing a majority of the board of directors. Certain events of default can be remedied by payment of money or otherwise, and companies sometimes have contractual rights to fix the default within a specified time period called the cure period or the grace period. If the event of default is remedied within the cure period, then the company is no longer in default and the remedies are no longer available. Some events of default constitute breaches of trust that cannot be restored, such as the intentional violation of a covenant by a company. For these latter kinds of events of default, there are usually no cure periods or methods for the company to get back in compliance so that all of the investors' remedies are exercisable.

Evergreen Fund: a fund that reinvests its profits in order to ensure the availability of capital for future investments.

Exercise Price: the price that must be paid by a security holder in order to convert a convertible security. The exercise price is also referred to as the strike price. If an option holder's exercise price is $.50, then the option holder must pay the company $.50 in order to exercise the option and purchase common stock. If a warrant holder has an exercise price of $2.25, then the warrant holder must pay the company $2.25 to exercise the warrant and thereby exchange the warrant for common stock. The exercise price can be nominal ($.001) or significant, and frequently relates to the purchase price of another security purchased in the same offering or at the same time.

Exit Strategies: the process by which the holder of a security in a private company achieves liquidity. Unlike public companies, private companies have no trading market for the resale of securities. The

normal exit strategies for an investor in a private company are a sale, IPO, redemption, or sale of the individual security to another stockholder. Registration rights are designed to help investors achieve liquidity by facilitating the sale of restricted securities after a private company goes public. Put rights are designed to permit investors to cause an issuer to effect a redemption of the investor's securities while the company is still private.

Expansion Stage: the stage of a company characterized by a complete management team and a substantial increase in revenues.

F

Fairness Opinion: a letter issued by an investment bank that charges a fee to assess the fairness of a negotiated price for a merger or acquisition.

Fair Market Value: the cash price that a willing buyer will pay to a willing seller for an asset. The fair market value of a company generally assumes the value of the company as an ongoing business. The fair market value of an individual security represents a proportionate interest in the fair market value of the company. Depending on the context and the contractual agreement, the fair market value of a security may or may not be adjusted or discounted to reflect factors such as liquidity, minority interest, voting rights, right to control management, and capital structure.

Firm Commitment: a commitment by a syndicate of investment banks to purchase all the shares available for sale in a public offering of a company. The shares will then be resold to investors by the syndicate.

Flipping: the act of selling shares immediately after an initial public offering. Investment banks that underwrite new stock issues attempt to allocate shares to new investors that indicate they will retain the shares for several months. Often management and venture investors are prohibited from selling IPO shares until a “lock-up period” (usually 6 to 12 months) has expired.

Float: See public float.

Founders: the individuals who started a company. Frequently founders are also key management and the controlling stockholders for a private company.

Founders Stock: nominally priced common stock issued to founders, officers, employees, directors, and consultants.

Free Cash Flow to Equity (FCFE): the cash flow available after operating expenses, interest payments on debt, taxes, net principal repayments, preferred stock dividends, reinvestment needs and changes in working capital. In a discounted cash flow model to determine the value of the equity of a firm using FCFE, the discount rate used is the cost of equity.

Free Cash Flow to the Firm (FCFF): the operating cash flow available after operating expenses, taxes, reinvestment needs and changes in working capital, but before any interest payments on debt are made. In a discounted cash flow model to determine the enterprise value of a firm using FCFF, the discount rate used is the weighted average cost of capital (WACC).

Friends and Family Financing: capital provided by the friends and family of founders of an early stage company. Founders should be careful not to create an ownership structure that may hinder the participation of professional investors once the company begins to achieve success.

Full Ratchet: a downward change in the conversion price (or exercise price) of a convertible security. For a full ratchet antidilution clause, the conversion price of the convertible security is reduced to the exact price at which any subsequent security of the issuer is sold at a lower price, regardless of the amount of subsequent securities sold. If an investor purchased convertible preferred stock that is initially convertible at $5 per share and the company subsequently sells even a single share of stock (common stock or preferred stock) at $2 per share, then, as a result of applying the full ratchet, the investor has the right to convert the investor's own convertible preferred stock at $2 per share rather than $5 per share. A full ratchet is generally not available if the stock purchased at a lower price is sold under the company's stock option plan. See Narrowbased weighted average ratchet and Broad-based weighted average ratchet.

Fully Diluted Basis: the total number of shares of common stock outstanding. To calculate the common stock on a fully diluted basis, assume that in addition to all of a company's currently issued and outstanding common stock, all convertible securities are converted into common stock, thereby creating the maximum number of issued and outstanding shares of common stock. All stock options that are currently exercisable by the holder (i.e., stock options that have vested) and whose current value exceeds the exercise price are treated as if the option has been exercised and the common stock issued. Similarly, convertible debt is treated as if the debt has been converted to common stock and the common stock issued.

Fund-of-Funds: a fund created to invest in private equity funds. Typically, individual investors and relatively small institutional investors participate in a fundof-funds to minimize their portfolio management efforts.

G

GAAP: generally accepted accounting principles.

Gas in the Tank: See Working Capital

Gatekeepers: intermediaries which endowments, pension funds and other institutional investors use as advisors regarding private equity investments.

General Partner (GP): a class of partner in a partnership. The general partner retains liability for the actions of the partnership. In the private equity world, the GP is the fund manager while the limited partners (LPs) are the institutional and high net worth investors in the partnership. The GP earns a management fee and a percentage of profits (see Carried interest).

GP: see General partner.

Going-Private Transaction: when a public company chooses to pay off all public investors, delist from all stock exchanges, and become owned by management, employees, and select private investors.

Green Shoe: the underwriter's over-allotment allocation in a securities offering, a standard feature of a public offering. This gives an underwriter the right (but not the obligation) to purchase additional stockin connection with a public offering. The green shoe is typically an additional 15 percent of the agreed-upon underwriting amount. The theoretical purpose of the over-allotment allocation is to permit the underwriter to stabilize the after-market for the companies' securities during the period immediately following a public offering. The over-allotment allocation is universally exercisable by the underwriter at any time during the 30 days following the IPO, including at the IPO closing. By purchasing additional securities available pursuant to the green shoe and immediately reselling the stock to the public, thereby increasing the public float, the underwriter can maintain a balance between the demand for a company's stock and the supply of stock available to satisfy the demand.

Grossing up: an adjustment of an option pool for management and employees of a company which increases the number of shares available over time. This usually occurs after a financing round whereby one or more investors receive a relatively large percentage of the company. Without a grossing up, managers and employees would suffer the financial and emotional consequences of dilution, thereby potentially affecting the overall performance of the company.

Growth stage: the state of a company when it has received one or more rounds of financing and is generating revenue from its product or service. Also known as“middle stage.”

H

Haircut: See underwriter's cutback.

Hamburger Helper: a colorful label for a traditional bridge loan that includes the right of the bridge lender to convert the note to preferred stock at a price that is a 20% discount from the price of the preferred stock in the next financing round.

Hart-Scott-Rodino Act: a law requiring entities that acquire certain amounts of stock or assets of a company to inform the Federal Trade Commission and the Department of Justice and to observe a waiting period before completing the transaction.

Harvest: to generate cash or stock from the sale or IPO of companies in a private equity portfolio of investments.

High Yield Debt: debt issued via public offering or public placement (Rule 144A) that is rated below investment grade by S&P or Moody’s. This means that the debt is rated below the top four rating categories (i.e. S&P BB+, Moody’s Ba2 or below). The lower rating is indicative of higher risk of default, and therefore the debt carries a higher coupon or yield than investment grade debt. Also referred to as Junk bonds or Sub-investment grade debt.

Hockey Stick: the general shape and form of a chart showing revenue, customers, cash or some other financial or operational measure that increases dramatically at some point in the future. Entrepreneurs often develop business plans with hockey stick charts to impress potential investors.

Holding Period: the period of time an investor is treated as the owner of a security for purposes of calculating the results under, or availability of, treatment of the security under the Internal Revenue Code or SEC rules. As a general rule, longer holding periods create better results for investors under

both tax and securities rules. Frequently, the holding periods for tax and securities purposes are calculated differently and in both cases produce results that may surprise investors. For example, if an investor buys stock and pays for it with a promissory note, the holding period under SEC Rule 144 commences only after the note is paid in full, rather than from the date the stockholder pays for the security by issuing the promissory note. For capital gains purposes, seemingly similar circumstances produce very different results. The holding period of common stock purchased pursuant to an option with a significant exercise price commences only when the stock is purchased (i.e., converted) rather than when the option is obtained. This holding period differs from that of common stock purchased pursuant to a convertible security. In the latter case, the holding period commences when the convertible security is originally purchased rather than when the conversion is effected.

Hot Issue: stock in an initial public offering that is in high demand.

Hurdle Rate: a minimum rate of return required before an investor will make an investment.

I

Incorporation: the process by which a business receives a state charter, allowing it to become a corporation. Many corporations choose Delaware because its laws are business-friendly and up to date.

Incubator: a company or facility designed to host startup companies. Incubators help startups grow while controlling costs by offering networks of contacts and shared back office resources.

Indenture: the terms and conditions between a bond issuer and bond buyers.

Initial Public Offering (IPO): the first offering of stock by a company to the public. New public offerings must be registered with the Securities and Exchange Commission. An IPO is one of the methods that a startup that has achieved significant success can use to raise additional capital for further growth. See Qualified IPO.

Inside Round: a round of financing in which the investors are the same investors as the previous round. An inside round raises liability issues since the valuation of the company has no third party verification in the form of an outside investor. In addition, the terms of the inside round may be considered self-dealing if they are onerous to any set of shareholders or if the investors give themselves additional preferential rights.

Institutional Investor: professional entities that invest capital on behalf of companies or individuals. Examples are: pension plans, insurance companies and university endowments.

Interest Coverage Ratio: earnings before interest and taxes (EBIT) divided by interest expense. This is a key ratio used by lenders to assess the ability of a company to produce sufficient cash to pay its debt obligation.

Internal Rate of Return (IRR): the interest rate at which a certain amount of capital today would have to be invested in order to grow to a specific value at a specific time in the future.

Investment Thesis / Investment Philosophy – the fundamental ideas which determine the types of investments that an investment fund will choose in order to achieve its financial goals.

IPO: the initial offering of a company's securities to the public pursuant to a registration statement filed with the SEC. see Initial public offering. IRR: see Internal rate of return.

Issuer: the entity whose securities are being sold.

J

Junior Debt: a loan that has a lower priority than a senior loan in case of a liquidation of the asset or borrowing company. Also known as “subordinated debt”.

Junk Bond: see High Yield Debt.

Key Man Life Insurance: life insurance on the life of a key executive that is payable to the company. Companies buy key man life insurance in order to minimize the possible disruption that would be caused to a business on the death of a key employee. The insurance proceeds are typically used to help attract new executives, to redeem either the stock of investors or the deceased, or for other corporate purposes.

L

Later Stage: the state of a company that has proven its concept, achieved significant revenues compared to its competition, and is approaching cash flow break even or positive net income. Typically, a later stage company is about 6 to 12 months away from a liquidity event such as an IPO or buyout. The rate of return for venture capitalists that invest in later stage, less risky ventures is lower than in earlier stage ventures.

LBO: see Leveraged buyout.

Lead Investor: the venture capital investor that makes the largest investment in a financing round and manages the documentation and closing of that round. The lead investor sets the price per share of the financing round, thereby determining the valuation of the company.

Letter of Intent: a document confirming the intent of an investor to participate in a round of financing for a company. By signing this document, the subject company agrees to begin the legal and due diligence process prior to the closing of the transaction. Also known as a “Term Sheet”.

Leverage: the use of debt to acquire assets, build operations and increase revenues. By using debt, a company is attempting to achieve results faster than if it only used its cash available from pre-leverage operations. The risk is that the increase in assets and revenues does not generate sufficient net income and cash flow to pay the interest costs of the debt.

Leveraged buyout (LBO): the purchase of a company or a business unit of a company by an outside investor using mostly borrowed capital.

Leverage ratios: measurements of a company’s debt as a multiple of cash flow. Typical leverage ratios include Total Debt / EBITDA, Total Debt / (EBITDA minus Capital Expenditures), and Senior Debt / EBITDA.

Liability: an amount owed by a company, including short-term and long-term liabilities. Shortterm liabilities are debt that must be paid within 12 months, such as amounts owed to suppliers (accounts payable), employees, and tax authorities. Long-term liabilities are debt that is due beyond one year, such as debt and lease obligations.

L.I.B.O.R.: see The London Interbank Offered Rate.

Limited Liability Company (LLC) – an ownership structure designed to limit the founders' losses to the amount of their investment. An LLC does not pay taxes, rather its owners pay taxes on their proportion of the LLC profits at their individual tax rates. Limited partnership: a legal entity composed of a general partner and various limited partners. The general partner manages the investments and is liable for the actions of the partnership while the limited partners are generally protected from legal actions and an Limited partner (LP): an investor in a limited partnership. The general partner is liable for the actions of the partnership while the limited partners are generally protected from legal actions and any losses beyond their original investment. The limited partner receives income, capital gains and tax benefits.

Liquidation: the selling off of all assets of a company prior to the complete cessation of operations. Corporations that choose to liquidate declare Chapter 7 bankruptcy. In a liquidation, the claims of secured and unsecured creditors, bondholders and preferred stockholders take precedence over common stockholders.

Liquidation Preference: is the amount of money an investor is entitled to receive prior to any distribution to holders of common stock. For preferred stockholders, the liquidation preference is always an amount equal to the purchase price. Frequently, liquidation preferences also include the amount of any unpaid accumulated dividends. Liquidation preferences can be shared between separate classes of stock, or separate classes can have different priorities of payment. Different series of preferred stock may each have a liquidation preference in proportion to their respective purchase prices. For example, if Series A Preferred Stock invested $5 million and Series B Preferred Stock invested $10 million, and both had respective liquidation preferences equal to their respective purchase prices, then in a sale or liquidation for less than $15 million (i.e., the sum of their liquidation preferences), two results would be common: The liquidation preferences could be pari passu. If the total funds available on sale were only $9 million, then $3 million would go to Series A and $6 million to Series B; i.e., the available liquidation proceeds are shared in the same proportion as the respective liquidation preferences. The liquidation preferences could be ranked. Series B Preferred Stock would have a liquidation preference that ranks ahead of Series A Preferred Stock since Series B made the investment after Series A. In this case, holders of Series B Preferred Stock would receive the entire $9 million available for distribution.

Liquidity: the ability of a security holder to convert a security to cash or to a security that is the equivalent of cash. Different assets have different levels of liquidity ranging from highly liquid assets such as letters of credit, certificates of deposit, or money market funds, to relatively illiquid assets such as restricted securities or real estate. Unlike securities in a public company that an investor can convert to cash by selling at any time, restricted securities in a private company can be converted to cash only under limited circumstances (generally on an IPO, sale, redemption, or private sale to another stockholder).Liquidity Discount: a decrease in the value of a private company compared to the value of a similar but publicly traded company. Since an investor in a private company cannot readily sell his or her investment, the shares in the private company must be valued less than a comparable public company.

Liquidity Event: a transaction whereby owners of a significant portion of the shares of a private company sell their shares in exchange for cash or shares in another, usually larger company. For example, an IPO is a liquidity event.

Lock-Up Agreement: an underwriter's right to require holders of restricted securities to refrain from selling restricted securities during a specified period following the effective date of a registration statement filed by the company with the SEC, usually on an IPO but sometimes in connection with subsequent public offerings. This right is designed to minimize the availability of new stock for sale to the public to permit the company to facilitate the company's successful public offering. Also referred to as a market standoff.

London Interbank Offered Rate (L.I.B.O.R.): the average rate charged by large banks in London for loans to each other. LIBOR is a relatively volatile rate and is typically quoted in maturities of one month, three months, six months and one year.

LP: see Limited partner.

M

Management Buyout (MBO): a leveraged buyout controlled by the members of the management team of a company or a division.

Management Fee: a fee charged to the limited partners in a fund by the general partner. Management fees in a private equity fund typically range from 0.75% to 3% of capital under management, depending on the type and size of fund.

Management Rights: the rights often required by a venture capitalist as part of the agreement to invest in a company. The venture capitalist has the right to consult with management on key operational issues, attend board meetings and review information about the company's financial situation.

Managing Underwriter: the investment banking firm that leads and controls the underwriting syndicate, including the investment banks that will be involved in selling the public offering. The managing underwriter is listed on the left side of the prospectus.

Market Capitalization: the value of a publicly traded company as determined by multiplying the number of shares outstanding by the current price per share.

Market Standoff: See lock up.

MBO: see Management buyout.

Mezz: see Mezzanine

Mezzanine: a layer of financing that has intermediate priority (seniority) in the capital structure of a company. For example, mezzanine debt has lower priority than senior debt but usually has a higher interest rate and often includes warrants. In venture capital, a mezzanine round is generally the round of financing that is designed to help a company have enough resources to reach an IPO.

Mezzanine Securities: has two common meanings. Mezzanine securities refers generally to securities that have superior financial characteristics compared to those of common stock; usually such securities have the characteristics of both debt and equity securities. Frequent examples of mezzanine securities are subordinated debt with warrants or various forms of convertible preferred stock (see preferred stock). The term mezzanine securities or a mezzanine financing is also used to describe the last private placement conducted prior to a company's IPO.

Middle Stage: the state of a company when it has received one or more rounds of financing and is generating revenue from its product or service. Also known as "growth stage."

Mini/Maxi Offering: a best efforts offering in which investors' funds are not accepted by the company unless a specified minimum number of securities (or dollar amount) is sold and in connection with which only a maximum number of these securities (or dollar amount) will be sold.

Multiples : a valuation methodology that compares public and private companies in terms of a ratio of value to an operations figure such as revenue or net income. For example, if several publicly traded computer hardware companies are valued at approximately 2 times revenues, then it is reasonable to assume that a startup computer hardware company that is growing fast has the potential to achieve a valuation of 2 times its revenues. Before the startup issues its IPO, it will likely be valued at less than 2 times revenue because of the lack of liquidity of its shares. See Liquidity discount.

N

Narrow-Based Weighted Average Ratchet: a type of anti-dilution mechanism. A weighted average ratchet adjusts downward the price per share of the preferred stock of investor A due to the issuance of new preferred shares to new investor B at a price lower than the price investor A originally received. Investor A's preferred stock is repriced to a weighted average of investor A's price and investor B's price. A narrow-based ratchet uses only common stock outstanding in the denominator of the formula for determining the new weighted average price.

NDA: see Non-disclosure agreement.

Net Operating Income (NOI): a measure of cash flow that excludes the effects of financing decisions. NOI is calculated as earnings before interest and taxes multiplied by one minus the tax rate. Also known as profit after taxes (NOPAT).

Net Worth: the difference between the assets and liabilities of an individual or an entity. If an investor owns stocks, bonds, a house, and other assets worth $2 million and has liabilities of $500,000 (including mortgage amounts and accrued taxes on appreciated assets stated at fair market value), then the investor has a net worth of $1.5 million. Similarly, if a company owns land, building, computers, and other tangible and intangible assets with a cost basis for financial statement purposes of $10 million and has liabilities of $9 million, then the company has a net worth of $1 million.

1934 Act: the Securities Exchange Act of 1934, the federal statute that governs the resale and market activities of securities, including securities exchanges. The 1934 Act also details the ongoing reporting and information requirements for public companies and certain stockholders, including the requirements governing the annual (Form 10-K), quarterly (Form 10-Q), and periodic (Form 8-K) reports to stockholders, and the rules governing proxy solicitations and tender offers.

Non-Compete Agreements: a protective agreement between a company and its employees or consultant(s) stipulating that the employee/consultant will not compete with the company after termination of the employment arrangement. To be legally enforceable, non-competition agreements must have a specified (and reasonable) time period and geographic limitation. Noncompetition agreements are also frequently entered into between the buyer and seller of a business. State laws vary widely on the enforceability of non-competition agreements, although generally non-competition agreements are more enforceable in the context of buying businesses than in connection with employment arrangements.

Non-Cumulative Dividends: dividends that are payable to owners of preferred stock at a specific point in time only if there is sufficient cash flow available after all company expenses have been paid. If cash flow is insufficient, the owners of the preferred stock will not receive the dividends owed for that time period and will have to wait until the board of directors declares another set of dividends.

Non-Interference: an agreement often signed by employees and management whereby they agree not to interfere with the company's relationships with employees, clients, suppliers and subcontractors within a certain time period after termination of employment.

Non-Solicitation: an agreement often signed by employees and management whereby they agree not to solicit other employees of the company regarding job opportunities.

Non-Disclosure Agreement (NDA): an agreement issued by entrepreneurs to protect the privacy of their ideas when disclosing those ideas to third parties.

Note: the evidence of debt. If an investor or bank makes a loan to a company, the company issues a note (i.e., a debt security) evidencing the debt and specifying the terms and conditions of the loan.

O

Offering: a distribution of securities from a company. An offering can be a public offering, a private placement, or a distribution of securities otherwise exempt from the registration requirements of the Securities Act.

Offering Memorandum: a legal document that provides details of an investment to potential investors. See Private placement memorandum.

OID: see Original issue discount.

Operating Cash Flow: the cash flow produced from the operation of a business, not from investing activities (such as selling assets) or financing activities (such as issuing debt). Calculated as net operating income (NOI) plus depreciation.

Optics: the way a concept is presented. Sometimes entrepreneurs' presentations are strong on optics but weak in content.

Options: the right (but not the obligation) to acquire a security during a specified period by paying an agreed amount of money (called the exercise price). The exercise price can be nominal ($.001) or significant. See Stock options.

Option Pool: a group of options set aside for long term, phased compensation to management and employees.

Original Issue Discount (OID): original issue discount. This complicated tax concept requires that an issuer amortize the premium resulting from the difference between the price at which a debt instrument is purchased and the principal amount paid to the holder at maturity, where the difference in the price paid and the premium to be received is certain in both timing and amount. OID calculations can apply to subordinated debt with warrants (or common stock) or, under certain circumstances, preferred stock. Investors who purchase securities subject to OID calculations and treatment will receive taxable income (and therefore use cash to pay taxes) despite their not receiving a corresponding current cash payment. For preferred stock, OID is received only to the extent that the company has earnings and profits during the accrual period.

Orphan: a startup company that does not have a venture capitalist as an investor.

Outstanding Shares: the total amount of common shares of a company, not including treasury stock, convertible preferred stock, warrants and options.

Oversubscription: when demand exceeds supply for shares of an IPO or a private placement.

P

Pay to Play: a clause in a financing agreement whereby any investor that does not participate in a future round agrees to suffer significant dilution compared to other investors. The most onerous version of "pay to play" is automatic conversion to common shares, which in essence ends any preferential rights of an investor, such as the right to influence key management decisions.

Pari Passu: an equal sharing among different groups. Separate classes of preferred stock are frequently structured to be pari passu with respect to liquidation preferences or dividends. As a consequence, on the sale of a company, all of the pari passu preferred stockholders would receive distributions in the same proportions as their relative liquidation preferences, rather than in the chronological order that the preferred stockholders purchased their respective stock. Frequently, the later rounds of preferred stock have liquidation preferences superior to earlier financing rounds so that the last capital invested is the first capital repaid, and the liquidation preferences are therefore not pari passu.

Participating Dividends: the right of holders of certain preferred stock to receive dividends and participate in additional distributions of cash, stock or other assets. Participating Preferred Stock: preferred stock the holder of which has the right on sale or liquidation to first receive an amount equal to the liquidation preference and, then, to convert the participating preferred stock into common stock so as to participate in the sale or liquidation proceeds again on an as-converted basis as a common stockholder. The participating preferred stockholders receive a return of their capital prior to the common stockholders. Participating preferred stock has been characterized as "having your cake and eating it too."

PE Ratio: see Price earnings ratio.

Piggyback Rights: rights of an investor to have his or her shares included in a registration of a startup's shares in preparation for an IPO.

PIPEs: see Private investment in public equities.

Placement Agent: a company that specializes in finding institutional investors that are willing and able to invest in a private equity fund. Sometimes a private equity fund will hire a placement agent so the fund partners can focus on making and managing investments in companies rather than on raising capital.

Portfolio Company: a company that has received an investment from a private equity fund.

Post-Money Valuation: the valuation of a company including the capital provided by the current round of financing. For example, a venture capitalist may invest $5 million in a company valued at $2 million "pre-money" (before the investment was made). As a result, the startup will have a postmoney valuation of $7 million.

PPM: see Private placement memorandum.

Preemptive Rights: an investor's right to purchase the investor's pro rata (i.e., proportionate) share of any additional securities issued by a company. Preemptive rights generally do not arise from the sale of securities issued to employees, directors, and consultants pursuant to agreed limits (frequently under a stock option plan) or from the issuance of securities in connection with independent mergers or acquisitions with unrelated third parties.

Preference: seniority, usually with respect to dividends and proceeds from a sale or dissolution of a company.

Preferred Stock: a type of stock that has certain rights that common stock does not have. These special rights may include dividends, participation, liquidity preference, anti-dilution protection and veto provisions, among others. Private equity investors usually purchase preferred stock when they make investments in companies.

Pre-Money Value: the valuation of a company prior to the current round of financing. For example, a venture capitalist may invest $5 million in a company valued at $2 million pre-money. As a result, the startup will have a "post-money" valuation of $7 million.

Price Earnings Ratio (PE ratio): the ratio of a public company's price per share and its net income after taxes on a per share basis.

Primary Offering: a sale of securities directly by a company from stock that was previously unissued. IPOs are frequently referred to as a primary offering, even though IPOs may involve the sale of securities by stockholders.

Primary Shares: shares sold by a corporation (not by individual shareholders). Private Company: a company that has not sold any securities in a public offering, or otherwise become subject to the

reporting requirements of the Securities Exchange Act. Businesses that have raised money by selling securities in a private placement remain private companies even though outside investors are securities holders. Private companies have no obligation to provide information about their business to the public or to their securities holders except to an extremely limited degree under state corporate law or except by contractual agreement with the investors. Because of various state and federal securities laws, there are no secondary trading markets for the securities of private companies.

Private Equity: equity investments in non-public companies.

Private Equity Companies: Private equity firms generally receive a return on their investment through one of three ways: an IPO, a sale or merger of the company they control, or a recapitalization. Unlisted securities may be sold directly to investors by the company (called a private offering) or to a private equity fund, which pools contributions from smaller investors to create a capital pool.

Private Investment in Public Equities (PIPES): investments by a private equity fund in a publicly traded company, usually at a discount.

Private Placement: the sale of a security directly to a limited number of institutional and qualified individual investors. If structured correctly, a private placement avoids registration with the Securities and Exchange Commission.

Private Placement Memorandum (PPM): a document explaining the details of an investment to potential investors. For example, a private equity fund will issue a PPM when it is raising capital from institutional investors. Also, a startup may issue a PPM when it needs growth capital. Also known as "Offering Memorandum."

Private Securities: securities that are not registered with the Securities and Exchange Commission and do not trade on any exchanges. The price per share is negotiated between the buyer and the seller (the "issuer").

Promote: see Carried interest.

Prospectus: a formal document that gives sufficient detail about a business opportunity for a prospective investor to make a decision. A prospectus must disclose any material risks and be filed with the Securities and Exchange Commission.

Prudent Man Rule: a fundamental principle for professional money management which serves as a basis for the Prudent Investor Act. The principle is based on a statement by Judge Samuel Putnum in 1830: "Those with the responsibility to invest money for others should act with prudence, discretion, intelligence and regard for the safety of capital as well as income."

Public Company: a company that has sold securities to the public in an IPO or otherwise become subject to the reporting requirements of the 1934 Act. Public companies must provide extensive, ongoing financial and narrative information about their business conditions, results, and prospects in annual, quarterly, and periodic reports that are filed with the SEC and available publicly. Trading in the securities of a public company is permitted subject to the provisions of the 1934 Act.

Public Float: the amount of common stock of a public company that is actually available for active trading in the public market. The calculation of a company's public float normally excludes securities held by officers, directors and affiliates of a company since officers and directors generally are not active traders. The public float also excludes securities that cannot be sold by agreement with the security holder. The smaller the public float, the less liquidity is available to someone seeking to sell stock. Many institutional investors (i.e., pension funds and mutual funds that buy large amounts of securities) will not purchase securities in a company whose public float is below a minimum size because the institutional investor will lack the ability to easily and quickly sell large amounts of securities.

Public Offering: a securities offering that has been registered with the SEC and is sold to the public usually by an underwriting syndicate.

Pull the Trigger: act on an acquisition. Usually used in reference to the signing of an LOI rather than the closing of a deal as in "He finally pulled the trigger on an acquisition."

Purchase Method: a merger accounting treatment whereby a buyer purchases the assets (and liability obligations) of a company at their market price and then records the difference between the purchase price and the book value of the assets as goodwill. This goodwill need not be amortized but must be valued annually and any decreases or increases in value must be reflected in the buyer's financial statements.

Purchase Price: the price paid by the initial holder of a security to the company that issued the security. For preferred stock, the liquidation preference is generally equal to the purchase price plus any unpaid accumulated dividends.

Put Right: the right (but not the obligation) of a security holder to force someone else to purchase the put holder's securities at a designated time (e.g., five years after the security is purchased) or upon a specified occurrence (e.g., the company commits an event of default). The put price either is a fixed price or is set according to specified terms and conditions, and pursuant to an agreed pricing formula. A put right provides investors with a safety net: even if management or the controlling stockholders do not want to sell the company or take it public, the investor nonetheless has the ability to achieve liquidity by requiring the company to redeem the investor's security at a price or on the conditions set. A put is the opposite of a call. (See call rights.)

Q

Qualified IPO: a public offering of securities valued at or above a total amount specified in a financing agreement. This amount is usually specified to be sufficiently large to guarantee that the IPO shares will trade in a major exchange (NASDAQ or New York Stock Exchange). Usually upon a qualified IPO preferred stock is forced to convert to common stock.

Qualified Small Business Stock: stock of qualifying domestic C corporations as defined under Section 1202 of the Internal Revenue Code. To qualify, a corporation's gross assets cannot exceed $50 million (on a tax basis), and at least 80 percent by value of the company's assets must be used in the active conduct of one or more qualified trades or businesses. Section 1202 does not apply to S corporations, limited liability companies, or limited partnerships. Qualified small business stock held for at least five years qualifies for a reduced long-term capital gains rate on sale and is also the beneficiary of certain preferential rollover treatment after a holding period of six months.

Quartile: one fourth of the data points in a data set. Often, private equity investors are measured by the results of their investments during a particular period of time. Institutional investors often prefer to invest in private equity funds that demonstrate consistent results over time, placing in the upper quartile of the investment results for all funds.

R

Ratchet: a mechanism to prevent dilution. An anti-dilution clause is a contract clause that protects an investor from a reduction in percentage ownership in a company due to the future issuance by the company of additional shares to other entities.

Realization ratio: the ratio of cumulative distributions to paid-in capital. The realization ratio is used as a measure of the distributions from investment results of a private equity partnership compared to the capital under management.

Recapitalization: the reorganization of a company's capital structure.

Red Herring: a preliminary prospectus filed with the Securities and Exchange Commission and containing the details of an IPO offering. The name refers to the disclosure warning printed in red letters on the cover of each preliminary prospectus advising potential investors of the risks involved.

Redeemable Preferred: preferred stock that can be redeemed by the owner (usually a venture capital investor) in exchange for a specific sum of money.

Redemption Rights: the right of an investor to force the startup company to buy back the shares issued as a result of the investment. In effect, the investor has the right to take back his/her investment and may even negotiate a right to receive an additional sum in excess of the original investment.

Registration: the process whereby shares of a company are registered with the Securities and Exchange Commission under the Securities Act of 1933 in preparation for a sale of the shares to the public.

Registration Rights: the rights of an investor in a startup regarding the registration of a portion of the startup's shares for sale to the public. Piggyback rights give the shareholders the right to have their shares included in a registration. Demand rights give the shareholders the option to force management to register the company's shares for a public offering. Often, registration rights are hotly negotiated among venture capitalists in multiple rounds of financing.

Registration Statement: a disclosure document filed with the SEC in connection with registering specific securities under the federal securities laws. A registration statement includes mandated financial and narrative information, including the prospectus.

Regulation D: an SEC regulation that governs private placements. Private placements are investment offerings for institutional and accredited individual investors but not for the general public. There is an exception that 35 non-accredited investors can participate.

Reps and warranties: In M&A transactions, representations and warranties are given by both parties to disclose material information. A representation is an assertion as to a fact, true on the date the representation is made, that is given to induce another party to enter into a contract or take some other action. A warranty is a promise of indemnity if the assertion is false. The terms "representation" and "warranty" are often used together in practice. If a representation is not true it is "inaccurate." If a warranty is not true it is "breached."

Restricted Shares: shares that cannot be traded in the public markets.

Return on Investment (ROI): the proceeds from an investment, during a specific time period, calculated as a percentage of the original investment. Also, net profit after taxes divided by average total assets.

Review Statement: a financial statement prepared by a CPA that involves a lower level of testing than an audited statement but more testing than a compilation statement. The CPA must be of the opinion that no material modifications would be made to the financial statement in order to conform to GAAP.

Rights Offering: an offering of stock to current shareholders that entitles them to purchase the new issue, usually at a discount.

Rights of Co-Sale With Founders: a clause in venture capital investment agreements that allows the VC fund to sell shares at the same time that the founders of a startup chose to sell.

Right of First Refusal: a contractual right to participate in a transaction. For example, a venture capitalist may participate in a first round of investment in a startup and request a right of first refusal in any following rounds of investment.

Road Show: presentations made in several cities to potential investors and other interested parties. For example, a company will often make a road show to generate interest among institutional investors prior to its IPO.

ROI: see Return on investment.

Rollup: the purchase of relatively smaller companies in a sector by a rapidly growing company in the same sector. The strategy is to create economies of scale. For example, the movie theater industry underwent significant consolidation in the 1960's and 1970's.

Round: a financing event usually involving several private equity investors.

Rule 144: a rule of the Securities and Exchange Commission that specifies the conditions under which the holder of shares acquired in a private transaction may sell those shares in the public markets.

Rule 506 Offerings: private placements conducted under SEC Rule 506. Rule 506 offerings can be sold to an unlimited number of accredited investors and are unlimited in dollar amount.

S

S Corporation: an ownership structure that limits its number of owners to 100. An S corporation does not pay taxes, rather its owners pay taxes on their proportion of the corporation's profits at their individual tax rates.

S-1: the most complete registration statement filed by a company with the SEC. It is used when shorter form registration statements are not available to a company either because the company's financial characteristics require an S-1 or because the company has not been a public company for at least one year. Shorter form registration statements such as Form SB-1 and Form SB-2 can be utilized by small business issuers for both primary and secondary offerings.

S-3: a Registration statement that is shorter and less complete than an S-1 and is available to domestic issuers that have been a public company for at least one year and satisfy certain other requirements, particularly a significant public float. S-3 is also referred to as a shelf registration and may be kept current for a period of two years by updating the financial statements and noting any material changes.

S-8: a Registration statement filed by an issuer to register employee benefit plans, including stock option plans.

Sale: the sale of a company's business either by sale of all, or substantially all, of the company's assets, by sale of all of its stock, or by merger.

SBIC: see Small Business Investment Company.

Scalability: a characteristic of a new business concept that entails the growth of sales and revenues with a much slower growth of organizational complexity and expenses. Venture capitalists look for scalability in the startups they select to finance.

Scale-Down: a schedule for phased decreases in management fees for general partners in a limited partnership as the fund reduces its investment activities toward the end of its term.

Scale-Up: the process of a company growing quickly while maintaining operational and financial controls in place. Also, a schedule for phased increases in management fees for general partners in a limited partnership as the fund increases its investment activities over time.

SEC: see Securities and Exchange Commission.

Secondary Market: a market for the sale of limited partnership interests in private equity funds. Sometimes limited partners chose to sell their interest in a partnership, typically to raise cash or because they cannot meet their obligation to invest more capital according to the takedown schedule. Certain investment companies specialize in buying these partnership interests at a discount.

Secondary Shares: shares sold by a shareholder (not by the corporation).

Secured Debt: debt that has seniority in case the borrowing company defaults or is dissolved and its assets sold to pay creditors.

Securities Act: the Securities Act of 1933, the federal statute that created the SEC and governs the original issuance of securities, including private placements, IPOs, and exempt transactions.

Securities Exchange Act of 1934: See 1934 Act.

Security: a document that represents an interest in a company. Shares of stock, notes and bonds are examples of securities.

Securities and Exchange Commission (SEC): the regulatory body that enforces federal securities laws such as the Securities Act of 1933 and the Securities Exchange Act of 1934.

Seed Capital: investment provided by angels, friends and family to the founders of a startup in seed stage.

Seed Stage: the state of a company when it has just been incorporated and its founders are developing their product or service.

Senior Debt: a loan that has a higher priority in case of a liquidation of the asset or company.

Seniority : higher priority.

Series: a division of a class of securities. Blank check preferred stock is a class of security, frequently subdivided into separate series that are sold at different times and that have different liquidation rights, preferences, prices, voting rights, or conversion rights.

Series A Preferred Stock: preferred stock issued by a fast growth company in exchange for capital from investors in the "A" round of financing. This preferred stock is usually convertible to common shares upon the IPO or sale of the company.

Small Business Investment Company (SBIC): a company licensed by the Small Business Administration to receive government capital in the form of debt or equity in order to use in private equity investing.

Spin Out: a division of an established company that becomes an independent entity.

Stock : a share of ownership in a corporation.

Stock options: a right to purchase or sell a share of stock at a specific price within a specific period of time. Stock purchase options are commonly used as long term incentive compensation for employees and management of fast growth companies.

Stock Option Plan: a long-term performance incentive plan designed to assist a company and its stockholders by providing economic incentives to employees, directors, and consultants to the company in the form of options to acquire common stock of the company at a fixed price and during a fixed term. Stock options are usually subject to vesting restrictions so that the option holder has an incentive to remain with the company for at least the vesting period in order to receive all of the options. Since options have value only if the stock price of the common stock that can be acquired increases, the option holder has an additional incentive as an option holder, not just as an employee, to help the company achieve operational and financial success.

Strategic Investor: a relatively large corporation that agrees to invest in a young company in order to have access to a proprietary technology, product or service. By having this access, the corporation can potentially achieve its strategic goals.

Strike Price: See exercise price.

Subordinated Debt: a loan that has a lower priority than a senior loan in case of a liquidation of the asset or company. Also known as "junior debt".

Sweat Equity: ownership of shares in a company resulting from work rather than investment of capital.

Syndicate: a group of investors that agree to participate in a round of funding for a company. Alternatively, a syndicate can refer to a group of investment banks that agree to participate in the sale of stock to the public as part of an IPO.

Synergy analysis: The concept that the value and performance of two companies combined will be greater than the sum of the separate individual parts. Synergy is a term that is most commonly used in the context of mergers and acquisitions. Synergy, or the potential financial benefit achieved through the combining of companies, is often a driving force behind a merger. Shareholders will benefit if a company's post-merger share price increases due to the synergistic effect of the deal. The expected synergy achieved through the merger can be attributed to various factors, such as increased revenues, combined talent and technology, or cost reduction.

Syndication: the process of arranging a syndicate.

T

Tag-Along Right: the right of a minority investor to receive the same benefits as a majority investor. Usually applies to a sale of securities by investors. Also known as Co-sale right.

Takedown: a schedule of the transfer of capital in phases in order to complete a commitment of funds. Typically, a takedown is used by a general partner of a private equity fund to plan the transfer of capital from the limited partners.

Takeover: the transfer of control of a company.

Ten Bagger: an investment that returns 10 times the initial capital.

Tender Offer: an offer to public shareholders of a company to purchase their shares.

Term Loan: a bank loan for a specific period of time, usually up to ten years in leveraged buyout structures.

Term Sheet: a document confirming the intent of an investor to participate in a round of financing for a company. By signing this document, the subject company agrees to begin the legal and due diligence process prior to the closing of the transaction. Also known as "Letter of Intent".

Terminal Value: The terminal value of an asset is its anticipated value on a certain date in the future. It is used in multi-stage discounted cash flow analysis and the study of cash flow projections for a several-year period. The perpetuity growth model is used to identify ongoing free cash flows. The exit or terminal multiple approach assumes the asset will be sold at the end of a specified time period, helping investors evaluate risk/reward scenarios for the asset. A commonly used value is enterprise value/EBITDA (earnings before interest, tax, depreciation and amortization) or EV/EBITDA. An asset's terminal value is a projection that is useful in budget planning, and also in evaluating the potential gain of an investment over a specified time period.

Tire-kickers: Buyers that can never pull the trigger on an acquisition.

Trade Secret: something that is not generally known, is kept in secrecy and gives its owners a competitive business advantage.

Tranche: a portion of a set of securities. Each tranche may have different rights or risk characteristics.

Treasury Stock: stock that has been issued by a company and then subsequently repurchased by the company (i.e., in a redemption) but that has not been retired and can therefore be reissued (i.e., sold again) by the company.

Turnaround: a process resulting in a substantial increase in a company's revenues, profits and reputation.

Two X: an expression referring to 2 times the original amount. For example, a preferred stock may have a "two x" liquidation preference, so in case of liquidation of the company, the preferred stock investor would receive twice his or her original investment.

U

Under Water Option: an option is said to be under water if the current fair market value of a stock is less than the option exercise price.

Underwriter: an investment bank that chooses to be responsible for the process of selling new securities to the public. An underwriter usually chooses to work with a syndicate of investment banks in order to maximize the distribution of the securities.

Underwriter's Cutback: the right of an underwriter to reduce the number of securities being sold in an offering, generally the number of those securities being sold by selling stockholders. This right is designed to facilitate the company's public offering. The cutback is usually pro rata to all selling stockholders in proportion to the shares they intend to sell. Also referred to as a haircut.

Underwriting Discounts and Commissions: the fees paid to the underwriter(s) in connection with a public offering. Discounts and commissions do not include the costs of a public offering such as SEC filing fees, printing, legal, or accounting costs, or stock transfer taxes.

Underwriting Syndicate: investment banks that act as a group to market a public offering, purchase the securities from the issuer, and then resell the securities to the public.

Unit: a security that consists of two or more securities sold in combination to achieve a particular financial result, generally a financial result that is difficult to structure into a single security. A common example is a unit consisting of one security that provides for protection of principal and an interest component (such as subordinated debt or redeemable preferred stock) combined with a different security that has the potential for equity appreciation based on the success of the business, such as options, warrants, or common stock.

Unsecured Debt: debt which does not have any priority in case of dissolution of the company and sale of its assets.

V

Venture Capital: a segment of the private equity industry which focuses on investing in new companies with high growth rates.

Venture Capital Method: a valuation method whereby an estimate of the future value of a company is discounted by a certain interest rate and adjusted for future anticipated dilution in order to determine the current value. Usually, discount rates for the venture capital method are considerably higher than public stock return rates, representing the fact that venture capitalists must achieve significant returns on investment in order to compensate for the risks they take in funding unproven companies.

Vintage: the year that a private equity fund stops accepting new investors and begins to make investments on behalf of those investors.

Vesting: the rate at which options granted under a stock option plan become exercisable by the option holder. Most stock option plans provide that options vest (and therefore become exercisable by the option holder) over a period of years so that the company gets the benefit of extended employment and performance from the option holder. A common pattern is for options to vest in equal percentages over three to five years, usually on the anniversary date of the option grant. If the option holder's relationship with the company ceases, then the option holder forfeits the options that have not yet become vested.

Voting rights: the rights of holders of preferred and common stock in a company to vote on certain acts affecting the company. These matters may include payment of dividends, issuance of a new class of stock, merger or liquidation.

W

Waiver: the voluntary process by which investors relinquish a contractual right (such as a covenant), usually by affirmative vote of at least a majority of the affected investors. The effect of granting a waiver is either that the issuer is not in breach of a contractual obligation or that the issuer can take an action that would otherwise be contractually prohibited.

Warrant: a security which gives the holder the right to purchase shares in a company at a predetermined price. A warrant is a long term option, usually valid for several years or indefinitely. Typically, warrants are issued concurrently with preferred stocks or bonds in order to increase the appeal of the stocks or bonds to potential investors.

Washout Round: a financing round whereby previous investors, the founders and management suffer significant dilution. Usually as a result of a washout round, the new investor gains majority ownership and control of the company.

Weighted Average: a form of antidilution protection that adjusts the conversion price or the amount of securities into which a convertible security converts when a subsequent offering of securities (common stock or preferred stock) is made at a lower price. Unlike full ratchet antidilution provisions, the weighted average price protection is affected by the size or amount of the subsequent issuance to reflect the actual adverse impact incurred by the security holder. The conversion price is reduced by applying a complicated formula based on the shares outstanding prior to the new issue of securities and the current conversion price, and the amount of money received by the issuer divided by the number of fully diluted shares of common stock outstanding after the new issue.

Weighted Average Cost of Capital (WACC): the average of the cost of equity and the after-tax cost of debt. This average is determined using weight factors based on the ratio of equity to debt plus equity and the ratio of debt to debt plus equity.

Weighted Average Ratchet: an anti-dilution protection mechanism whereby the conversion rate of preferred stock is adjusted in order to reduce an investor's loss due to an increase in the number of shares in a company. Without a ratchet, an investor would suffer from a dilution of his or her percentage ownership. Usually as a result of the implementation of a weighted average ratchet, company management and employees who own a fixed amount of common shares suffer significant dilution, but not as badly as in the case of a full ratchet.

Wipeout Round: see Washout round.

Wipeout Bridge: a short term financing that has onerous features whereby if the company does not secure additional long term financing within a certain time frame, the bridge investor gains ownership control of the company. See Bridge financing.

Write-Down: a decrease in the reported value of an asset or a company.

Write-Off : a decrease in the reported value of an asset or a company to zero.

Write-Up: an increase in the reported value of an asset or a company.