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# Private Equity Academy

A series of masterclasses designed for dealmakers  
and other private equity professionals.

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# Meet Your Presenters

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**Liam Arthur**

Partner  
Private Equity M&A

+44.20.7280.2182  
[larthur@proskauer.com](mailto:larthur@proskauer.com)



**Rebecca Villarreal**

Partner  
Private Equity M&A

+44.20.7280.2030  
[rvillarreal@proskauer.com](mailto:rvillarreal@proskauer.com)



**Matt Clift**

Associate  
Private Equity M&A

+44.20.7280.2084  
[mclift@proskauer.com](mailto:mclift@proskauer.com)

# Certainty of Price and Pricing Mechanisms

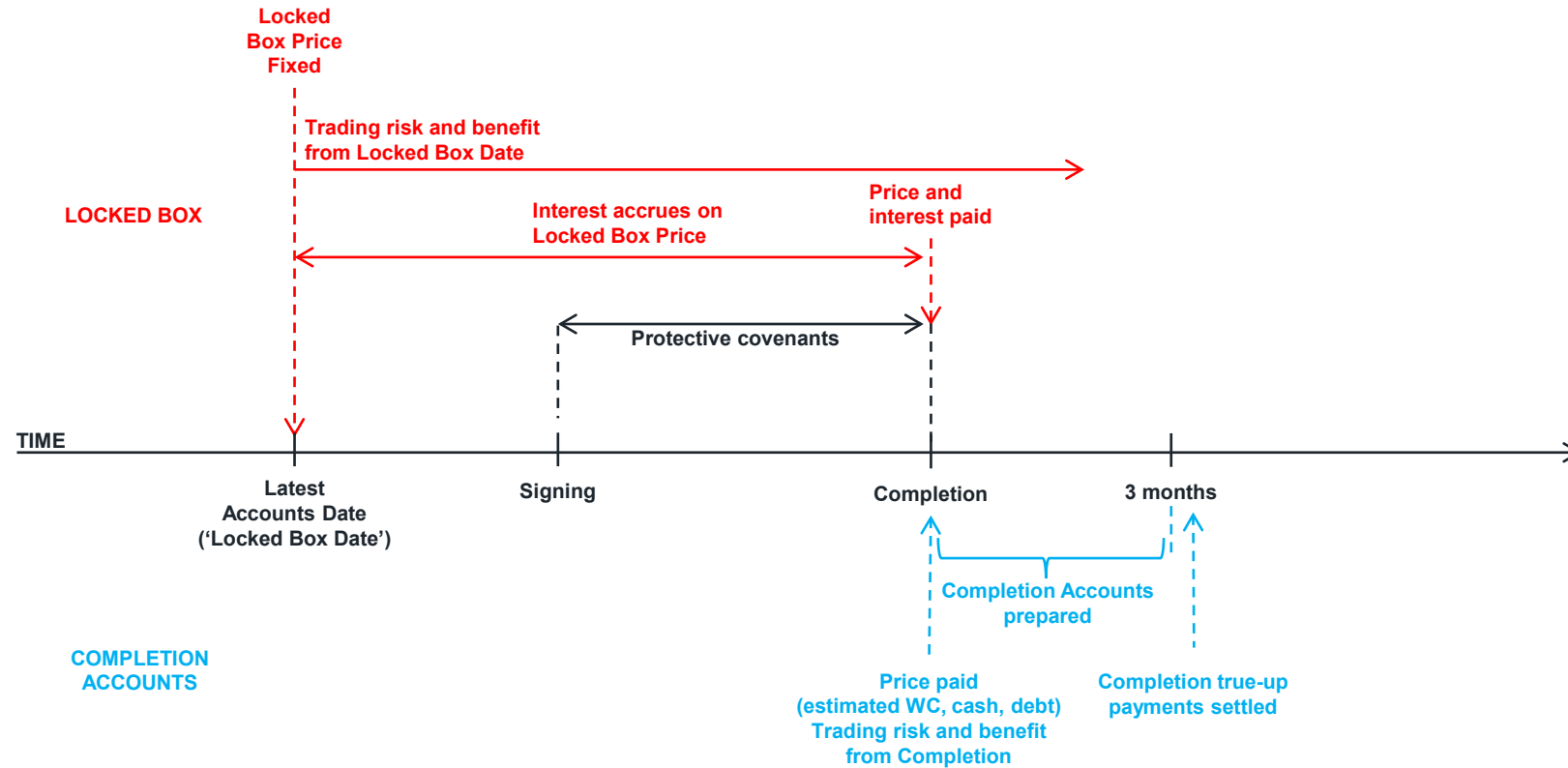
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Ensure that consideration paid reflects the agreed value for the business:

- *Locked box*
- *Completion accounts adjustment*
- *Deferred and contingent consideration*
- *Earn-outs*

These mechanisms are not the same as the **valuation methodology** used to establish the agreed value (e.g. EBITDA multiple, net asset valuation, discounted cash flow, etc.)

# Pricing Mechanisms





# Locked Box

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- **Locked box:** price paid on completion is fixed by reference to date of locked-box accounts, with sellers obliged to repay any value that leaks to them from the “box” after that date.
- Locked box negotiations:
  - Ticker
  - Limitations on liability (time, financial caps, de minimis)
  - Definitions of Leakage and Permitted Leakage



# Locked Box

Leakage	Permitted Leakage
Intended to capture any transfer of value to (or for the benefit of) the Sellers and their affiliates	Typically captures normal trading payments as well as unusual payments
Examples <ul style="list-style-type: none"> <li>- dividends</li> <li>- transfer of Target assets at less - than FMV</li> <li>- management fees</li> <li>- bonuses</li> <li>- release of obligations</li> </ul>	Certain non-ordinary course payments typically deducted from the purchase price in the EV to Equity Bridge (e.g. transaction bonuses and transaction fees to be paid by the Target at completion).
Broadly defined	Specific and tightly defined (e.g. transaction bonuses of \$X).
Seller, buyer and financial advisors should review the items carefully.	

# Completion Accounts

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- Completion Accounts Adjustment:

- Price paid on completion based on pre-completion estimates of certain agreed items (e.g. cash, debt and working capital)
- Adjusted following completion based on actual figures
- Economic risk and reward passes to buyer at completion

- Preparation of Completion Accounts:

- Procedure, review and dispute resolution
- Timing



# Completion Accounts

	Estimated	Actual
Cash	£35m	£37m
Debt	£55m	£59m
NWC (Target = £22m)	£22m	£20.5m

- Purchase price paid at completion

- EV: £350m
- Plus est. cash: £35m
- Less est. debt: (£55m)
- Plus est. NWC > target: Nil
- **Total:** **£335m**



# Completion Accounts

	Estimated	Actual
Cash	£35m	£37m
Debt	£55m	£59m
NWC (Target = £22m)	£22m	£20.5m

- Additional amount payable following completion accounts true-up

- Plus actual cash less est.: £2.0m
- Less actual debt less est.: (£4.0m)
- Plus actual NWC less est.: (£1.5m)
- **Total:** **(£3.5m)**

# Locked Box Considerations

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- Locked Box – sellside considerations:

- is generally advantageous, provides price certainty;
- more straight forward option;
- no benefit if value increases between LBD and completion (if business is very seasonal or has variable working capital then LB may not be appropriate).

- Locked Box – buy-side considerations:

- ensuring Leakage definition is widely defined;
- diligence and warranties on locked box accounts and also controls on actions between LBD and completion.

# Completion Accounts Considerations

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- Completion Accounts – sellside considerations:

- suitability for corporate carve-outs / where transaction perimeter isn't known at the outset of transaction; and
- increased complexity and risk of disputes.

- Completion Accounts – buy-side considerations:

- generally advantageous, as price paid reflects actual value of business at completion; and
- less focus/ reliance on FDD of historic accounts given adjustment period post-completion.

# Deferred Consideration / Earn-outs

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*Bridging the pricing gap, liability holdbacks and uncertainty on performance*

- **Deferred or contingent consideration.**
  - Trigger for payment: e.g. time, settling claims, closing add-on M&A transaction, completion of group re-org, signing a key commercial contract.
- **Earn-outs:**
  - Linked to ongoing employment and achievement of agreed targets.

## Consider:

- covenants,
- determination methodology,
- future proofing,
- escrows, and
- tax issues.

# Certainty of Closing – Conditionality

- Types of conditions.
- Mandatory, suspensory regulatory conditions:
  - FDI and Antitrust.
  - Regulated sectors – e.g. financial services.
- Other:
  - Financing conditions.
  - MACs.
  - Deal specific (e.g. change of control consent from major customer or supplier).





# Conditionality Considerations

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- Level of obligation (i.e. HOHW)
- Timing/ long stop date
- Responsibility for satisfaction of conditions
- Information rights/ involvement of counterparty
- Waivers
- Commercial context
- Identity of counterparty seeking approval and execution risk
- Consequences of non-satisfaction i.e. break fees

# Operation of the Business in 'Gap' Period

- Gap period covenants in favour of the buyer:
  - Negative / positive covenants.
  - Gun-jumping risk?
- Seller friendly protections / carve outs.
- Remedies for breach?



# Risk Allocation – Unknown Liabilities

- Warranties as the baseline protection
- Tax covenant for non-ordinary course pre-completion tax liabilities
- W&I insurance
- Known vs. unknown liabilities



# Risk Allocation – Known Liabilities

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- Known/ quantifiable liabilities
- Price reduction vs. Indemnity
- Indemnities – obligation to pay on occurrence of specific event of loss
  - £ for £
  - No need to prove damages
  - not subject to typical carve-outs around causation/ mitigation
- Need to coordinate carefully with other advisors

## Risk Allocation – Known Liabilities (cont.)

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- Caps/ baskets/ other limitations
- Negotiation of indemnities:
  - Example



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