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M&A as a Growth Strategy: The CFO's Role in Buy-Side Transactions

The acquisition thesis and financial criteria, target screening, financial due diligence, acquisition financing structures, LOI and purchase agreement financial terms, and CFO analytical responsibilities

WHAT YOU WILL LEARN AND WHY IT MATTERS

Acquisitions are one of the primary value creation strategies for growth equity-backed companies, and the CFO's role in the acquisition process — from target identification through deal closing — is both analytically demanding and organizationally consequential. The CFO who approaches acquisitions as a reactive participant — reviewing financial statements when asked, approving financing when directed, and managing the accounting when the deal closes — is providing a fraction of the potential value. The CFO who is an active, analytically prepared participant in every stage of the acquisition process — who brings financial analysis to the strategic discussion, who leads the financial due diligence with depth and rigor, and who structures the financing with creativity and discipline — is providing financial leadership that directly affects the quality and value of the acquisition outcome.

This part covers the CFO's specific responsibilities at each stage of the buy-side acquisition process: the financial criteria that define the acquisition thesis, the target screening methodology, the financial due diligence framework, the acquisition financing analysis, and the LOI and purchase agreement terms that most directly affect the financial outcome.

THE ACQUISITION THESIS AND FINANCIAL CRITERIA

Every acquisition should be grounded in a specific acquisition thesis — a clear articulation of why the acquired business will be more valuable as part of the combined company than as a standalone entity, and how the acquisition price paid is justified by the value created through the combination. The CFO's role in developing the acquisition thesis is to translate the strategic rationale into specific financial projections: the revenue synergies (the incremental revenue the combined company will generate that neither company could have generated independently), the cost synergies (the operating costs that will be eliminated through the combination), and the multiple expansion (the increase in valuation multiple that the combined company's improved financial profile will command relative to the acquired company's standalone multiple).

FINANCIAL CRITERIA FOR TARGET SCREENING: The financial criteria that define the target screening parameters should be derived from the acquisition thesis. If the growth equity investor's thesis is based on revenue acceleration, the financial criteria should emphasize revenue growth rate and net revenue retention as primary screening factors. If the thesis is based on geographic expansion, the financial criteria should emphasize the revenue profile of the target's customer base in the target geography. If the thesis is based on capability acquisition, the financial criteria may de-emphasize near-term financial metrics in favor of product and technology capability metrics.

Standard financial screening criteria for growth-stage acquisitions typically include: minimum and maximum revenue size (defining the range of companies large enough to be meaningful and small enough to be integrable), gross margin floor (ensuring the acquired business meets the combined company's gross margin targets), growth rate range (screening for companies that are growing fast enough to contribute to the combined company's growth but not so fast that they will be distracted by their

own organic growth opportunities), and profitability or cash burn threshold (ensuring the acquisition does not significantly increase the combined company's cash consumption beyond what the current financing can support).

FINANCIAL DUE DILIGENCE: THE CFO'S FRAMEWORK

Financial due diligence in a buy-side transaction is the CFO's most analytically intensive work in the acquisition process. It is the process by which the acquiring company independently verifies the accuracy and quality of the target's financial information, identifies the risks and liabilities that are not visible on the face of the financial statements, and develops the financial projections that underlie the valuation and the acquisition decision.

QUALITY OF EARNINGS: The quality of earnings analysis is the most important element of financial due diligence. It examines the target's historical EBITDA — the primary valuation metric in most acquisition negotiations — and assesses whether the reported EBITDA accurately represents the sustainable, recurring earnings power of the business. The quality of earnings analysis adjusts the reported EBITDA for: non-recurring items (one-time expenses or revenues that inflated or deflated EBITDA in specific periods), above-market owner compensation (the management compensation that a professional management team would receive, which is often lower than owner-operator compensation in private businesses), and accounting policy differences (the impact on EBITDA of applying the acquirer's accounting policies rather than the target's).

The output of the quality of earnings analysis is the adjusted EBITDA — the normalized, recurring earnings power that forms the basis for the acquisition multiple and the purchase price negotiation. If the quality of earnings analysis reveals that the reported EBITDA has been inflated by non-recurring items or aggressive accounting, the adjusted EBITDA will be lower than the reported EBITDA and the appropriate purchase price (calculated as a multiple of adjusted EBITDA) will be lower than the price implied by the reported EBITDA.

WORKING CAPITAL ANALYSIS: The working capital analysis in financial due diligence establishes the target working capital — the level of working capital required for the business to operate normally — which is used to calculate the working capital adjustment in the purchase price. Most acquisition agreements include a working capital adjustment mechanism: if the actual working capital delivered at closing is above the target, the purchase price increases; if it is below the target, the purchase price decreases. The CFO must define the working capital target with precision — the specific components included in the working capital calculation, the seasonal variation in working capital, and the adjustments for any unusual items — to prevent a post-closing purchase price dispute.

CONTINGENT LIABILITIES: The financial due diligence must identify and quantify all significant contingent liabilities that could affect the value of the acquisition. These include litigation exposure, tax contingencies (underpaid taxes, aggressive tax positions that may be challenged, state and local tax nexus issues), environmental liabilities, warranty obligations, and deferred revenue obligations that will require cash to fulfill. Each contingent liability must be assessed for its probability of materialization and its

potential magnitude, and the aggregate contingent liability exposure must be considered in the purchase price negotiation and in the representations and warranties provisions of the purchase agreement.

ACQUISITION FINANCING STRUCTURES

Growth-stage acquisitions are typically financed through a combination of the company's existing cash, debt financing from banks or private credit funds, and equity consideration (shares of the acquiring company issued to the target's shareholders). The CFO's role in structuring the acquisition financing is to identify the combination of cash, debt, and equity that minimizes the cost of the acquisition, preserves the acquiring company's financial flexibility for ongoing operations and future acquisitions, and satisfies the financial covenant requirements of the growth equity investment agreement.

DEBT FINANCING FOR ACQUISITIONS: Acquisition debt — typically a term loan or a revolving credit facility provided by a bank or a private credit fund — allows the company to acquire a target without deploying as much equity capital, thereby preserving the existing equity for other uses. The amount of acquisition debt the company can support depends on the combined company's EBITDA — lenders typically provide three to four times EBITDA for growth-stage acquisition financing — and on the financial covenant requirements of the growth equity investment agreement, which may limit the company's total debt leverage.

The CFO must model the combined company's debt service coverage — the ratio of EBITDA to annual debt service (principal plus interest) — to ensure that the debt level is serviceable at realistic EBITDA levels after the acquisition closes and synergies are being realized. A debt service coverage ratio that is adequate at the acquisition model EBITDA but inadequate if the integration takes longer than expected or the synergies are partially realized is an acquisition financing structure that creates financial risk.

EQUITY CONSIDERATION: Using equity as consideration in an acquisition — issuing shares of the acquiring company to the target's shareholders rather than paying entirely in cash — preserves the acquiring company's cash but dilutes the existing shareholders. The CFO must assess the dilution impact of the equity consideration on the existing cap table and must ensure that the board and the existing investors understand and accept the dilution before the acquisition agreement is signed.

LOI AND PURCHASE AGREEMENT FINANCIAL TERMS

The letter of intent (LOI) and the definitive purchase agreement contain the financial terms that determine the economic outcome of the acquisition. The CFO must be actively involved in negotiating these terms, because they establish the financial framework within which the post-closing accounting, the working capital adjustment, and any post-closing purchase price adjustments will be determined.

KEY FINANCIAL TERMS IN THE LOI: The LOI typically specifies the purchase price and the price basis (cash-free and debt-free, specific working capital target, net of estimated transaction fees), the form of

consideration (cash, stock, or a combination), the escrow or holdback structure (a portion of the purchase price typically withheld in escrow for twelve to eighteen months to cover indemnification claims), and the exclusivity period (the period during which the target agrees not to negotiate with other potential acquirers). Each of these terms has significant financial implications that the CFO must model before the LOI is signed.

THE REPRESENTATIONS AND WARRANTIES INSURANCE: Representations and warranties insurance (RWI) — an insurance policy that covers losses arising from breaches of the representations and warranties in the purchase agreement — has become the standard risk management tool in middle-market and growth-stage acquisitions. From the CFO's perspective, RWI insurance allows the acquirer to negotiate a clean purchase agreement without the extensive survival periods and indemnification caps that were previously required to protect the acquirer from unknown pre-closing liabilities. The CFO must model the cost of the RWI premium (typically one to two percent of the insured amount) against the risk protection it provides and should include this cost in the acquisition financial model.

ACTIONS TO TAKE BEFORE PART FIFTEEN

Build the acquisition financial model template: a standard model structure that can be adapted to evaluate specific acquisition opportunities quickly, including the quality of earnings adjustments, the synergy assumptions, the debt service coverage calculation, the working capital target methodology, and the returns analysis that calculates the equity return on the acquisition investment under different synergy realization scenarios. Having a standard template ready before a specific opportunity is identified ensures that the financial analysis can be produced quickly when a time-sensitive acquisition opportunity arises.

Review the growth equity investment agreement's acquisition consent requirements: most growth equity agreements require investor consent for acquisitions above a specified size (typically defined as a purchase price above a specified dollar amount or a specified percentage of the company's assets). Understanding these consent requirements in advance allows the CFO to plan the acquisition approval process with sufficient lead time to avoid deal timing pressure.

CLOSING PERSPECTIVE

M&A; is the most financially complex and most organizationally demanding activity in the growth-stage CFO's portfolio. The CFO who is analytically prepared for every stage of the acquisition process — who brings financial rigor to the acquisition thesis, depth to the financial due diligence, creativity to the financing structure, and precision to the LOI and purchase agreement terms — is creating direct financial value in the acquisition outcome. The CFO who is a reactive participant in this process is accepting a fundamentally diminished role in one of the company's most consequential financial activities.

COMING NEXT IN THE SERIES

Part 15 — Integration Finance: Managing the First 100 Days After an Acquisition

Part Fifteen covers the financial integration of an acquired business — the Day 1 readiness requirements, financial system integration, chart of accounts harmonization, the combined company reporting structure, synergy realization tracking, and the purchase price accounting mechanics that establish the integrated company's financial baseline.