The QoEPro Deal Dictionary

A Glossary for LMM Buyers

A plain-language reference for common terms in lower middle market M&A, search fund and ETA transactions, and Quality of Earnings due diligence. Definitions reflect how these terms are used in practice, not just in textbooks.

60 terms defined

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A

Addback

(also: adjustment)

An expense added back to reported earnings to arrive at adjusted EBITDA or SDE. Addbacks typically include owner-specific costs (personal expenses, above-market compensation) and non-recurring items (one-time legal fees, transaction costs) that won't persist under new ownership. The quality and defensibility of addbacks is one of the central questions in any Quality of Earnings analysis.

Adjusted EBITDA

EBITDA after removing non-recurring items and normalizing owner-related expenses to arrive at a cleaner picture of sustainable operating earnings. This is the number most purchase price multiples are applied to in middle market transactions. See also: EBITDA, Addback.

Asset Sale

A transaction structure in which the buyer purchases specific assets of a business rather than its equity. Common in lower middle market deals. Buyers generally prefer asset sales because they receive a stepped-up tax basis and avoid inheriting unknown liabilities. Sellers generally prefer stock sales for tax reasons.

APA

(Asset Purchase Agreement)

The definitive legal agreement governing an asset sale. Specifies which assets and liabilities are included, representations and warranties made by each party, purchase price mechanics, and closing conditions.

B

Buy-Side QoE

A Quality of Earnings report commissioned by the buyer, typically after an LOI is signed. The analyst works on behalf of the buyer and approaches the seller's financials with independent skepticism. Findings may result in price adjustments, deal structure changes, or deal termination in cases of material misrepresentation. See also: Sell-Side QoE.

Business Broker

An intermediary who facilitates the sale of small and lower middle market businesses, typically earning a commission on the transaction. Brokers represent the seller and present the business in the most favorable light, which is important context when reviewing any materials they provide.

C

Capitalization Rate

(Cap Rate)

The rate of return on a real estate or business investment based on expected income. In M&A;, occasionally used as an alternative valuation lens to EBITDA multiples, particularly for asset-heavy businesses.

Carve-Out

A transaction in which a parent company sells a division, subsidiary, or business unit as a standalone entity. Carve-outs often require extra diligence because the carved entity may share costs, systems, or personnel with the parent that will need to be replicated post-close.

CIM

(Confidential Information Memorandum)

A marketing document prepared by the seller or their broker that presents the business to prospective buyers. Includes financial summaries, business description, market overview, and growth opportunities. CIMs are written to sell the business; the financial figures presented, particularly adjusted EBITDA, reflect the seller's most favorable interpretation of the numbers.

Closing Conditions

Requirements that must be satisfied before a transaction can close. Common examples include regulatory approvals, lender financing, material adverse change clauses, and the accuracy of representations and warranties at closing.

Customer Concentration

The degree to which a business's revenue is dependent on a small number of customers. High concentration is a risk factor: losing one major customer can dramatically impair earnings. A common rule of thumb is that any single customer representing more than 20% of revenue warrants investigation during due diligence.

D

Data Room

A secure online repository where a seller makes due diligence documents available to prospective buyers. Contents typically include financial statements, tax returns, contracts, employee information, and legal documents. The completeness and organization of a data room often signals how prepared and transparent a seller is.

DCF

(Discounted Cash Flow)

A valuation methodology that estimates the value of a business based on the present value of its projected future cash flows. Less common in lower middle market transactions due to the difficulty of producing reliable long-term projections for owner-operated businesses; multiple-based valuation is more typical.

Deal Structure

The combination of transaction type (asset vs. stock sale), payment mechanics (cash at close, earnout, seller note), and legal agreements that define how a transaction is executed. Deal structure affects tax treatment, risk allocation, and post-close incentives for both parties.

Due Diligence

The investigative process a buyer undertakes before closing a transaction to verify the seller's representations and assess the risks of the acquisition. Typically includes financial due diligence (QoE), legal due diligence, operational due diligence, and sometimes HR or environmental review, depending on the business.

E

Earnout

A contingent payment structure in which the seller receives additional consideration after closing, tied to the business achieving specified performance targets. Earnouts bridge valuation gaps between buyers and sellers but frequently generate post-close disputes. The more precisely the earnout metric and calculation methodology are defined in the purchase agreement, the better.

EBITDA

(Earnings Before Interest, Taxes, Depreciation, and Amortization)

The most commonly used earnings metric in middle market M&A.; EBITDA strips out financing costs, tax structure, and non-cash charges to focus on operating performance. In lower middle market deals, EBITDA is typically adjusted further to remove non-recurring items and normalize owner compensation. See also: Adjusted EBITDA, SDE.

Escrow

Funds held by a neutral third party after closing to cover potential indemnification claims. Typically 10-15% of purchase price held for 12-24 months. Escrow protects the buyer if post-close representations and warranties are found to be inaccurate.

ETA

(Entrepreneurship Through Acquisition)

A path to business ownership in which an individual or small team raises capital to search for and acquire an existing business, then operates it as CEO. The ETA model has grown significantly in the lower middle market, driven by the retirement of baby boomer business owners and the availability of SBA financing. Search funds are a formal version of this model; self-funded searchers operate without a search fund structure.

F

Free Cash Flow

(FCF)

Operating cash flow minus capital expenditures. A more conservative earnings measure than EBITDA because it accounts for the cash a business must reinvest to maintain its operations. In capital-intensive businesses, EBITDA and free cash flow can diverge significantly.

Full Ratchet

An anti-dilution provision in equity agreements that adjusts the conversion price of preferred stock to match any lower-priced issuance. More common in venture capital than LMM transactions but occasionally appears in PE-backed deals.

G

GAAP

(Generally Accepted Accounting Principles)

The standard accounting framework used in the United States. Many lower middle market businesses do not prepare GAAP-compliant financials, which is one reason Quality of Earnings analyses are valuable: they assess economic reality rather than technical compliance.

Goodwill

The intangible value paid above the fair value of a business's identifiable net assets. In M&A;, goodwill often reflects customer relationships, brand reputation, and workforce value. In asset sales, goodwill is amortizable over 15 years for tax purposes, which is a meaningful benefit to buyers.

H

Hold Period

The length of time a private equity firm or investor expects to own a business before exiting. Typical PE hold periods are 3-7 years. For ETA buyers, the hold period is often longer and may not have a defined exit timeline.

I

Indemnification

A contractual obligation by one party (typically the seller) to compensate the other for losses arising from breaches of representations, warranties, or covenants in the purchase agreement. The scope, caps, baskets, and survival periods of indemnification provisions are heavily negotiated in LMM transactions.

Independent Sponsor

A deal-by-deal private equity investor who does not manage a committed fund. Independent sponsors identify acquisition targets and then raise equity capital from investors on a transaction-by-transaction basis. Common in the lower middle market, where deal sizes are too small for most institutional PE funds.

IOI

(Indication of Interest)

A non-binding document submitted early in a deal process to express interest in acquiring a business and indicate a preliminary valuation range. Less detailed than an LOI and used primarily in competitive auction processes to narrow the buyer field.

L

LBO

(Leveraged Buyout)

An acquisition financed primarily with debt, using the acquired business's assets and cash flows as collateral. Common in PE transactions. In the lower middle market, SBA 7(a) loans are a frequently used form of acquisition financing that functions similarly.

LMM

(Lower Middle Market)

The segment of the M&A; market typically defined as businesses with $5-50M in revenue or $1-10M in EBITDA, though definitions vary by firm and context. The LMM is characterized by owner-operated businesses, less institutional financial reporting, and a buyer universe dominated by search funds, independent sponsors, family offices, and small PE firms.

LOI

(Letter of Intent)

A non-binding agreement between buyer and seller that outlines the key terms of a proposed transaction, including purchase price, deal structure, exclusivity period, and major conditions. Signing an LOI typically triggers the formal due diligence process. While non-binding on price, LOIs are often binding on exclusivity and confidentiality provisions.

M

M&A;

(Mergers and Acquisitions)

The broad category of transactions involving the consolidation of companies or assets. In the lower middle market context, most transactions are acquisitions of privately held, owner-operated businesses rather than mergers of equals.

Management Buyout

(MBO)

A transaction in which the existing management team acquires the business, typically with outside financing. MBOs are common when an owner wants to sell to someone already familiar with operations rather than an outside buyer.

Multiple

The factor applied to an earnings metric (typically EBITDA or SDE) to arrive at an enterprise value. A business valued at 5x EBITDA of $1M has an enterprise value of $5M. Multiples vary significantly by industry, growth rate, business quality, and deal size. Lower middle market businesses generally trade at lower multiples than mid-market or large-cap businesses.

N

NDA

(Non-Disclosure Agreement)

A confidentiality agreement signed before a seller shares detailed business information with a prospective buyer. Standard early step in any M&A; process.

Net Working Capital

(NWC)

Current assets minus current liabilities. In M&A;, the buyer and seller negotiate a working capital target, the amount of NWC expected to be in the business at close to sustain normal operations. If actual NWC at close differs from the target, the purchase price is adjusted accordingly. Working capital disputes are among the most common sources of post-close conflict. See also: Working Capital Peg.

Non-Compete Agreement

A contractual provision preventing the seller from competing with the business for a defined period and within a defined geography after closing. Standard in LMM deals. Buyers rely on non-competes to protect the value of goodwill and customer relationships acquired in the transaction.

Normalized Earnings

Earnings adjusted to remove the effect of non-recurring items, owner-specific expenses, and other distortions, producing a figure that represents the business's sustainable earning power under new ownership. The output of a Quality of Earnings analysis.

O

Owner-Operator

A business owner who is also actively involved in day-to-day operations, often performing functions that would require a hired employee to replace. Owner-operator businesses are common in the lower middle market and require careful analysis of how much of their earnings depend on the owner's personal involvement.

P

Platform Acquisition

An initial acquisition that serves as the foundation for a buy-and-build strategy, with subsequent add-on acquisitions integrated into the platform over time. PE firms commonly use this approach in the lower middle market to build scale in a fragmented industry.

Purchase Price Adjustment

A mechanism in the purchase agreement that modifies the final purchase price based on the actual financial condition of the business at closing, most commonly tied to net working capital, cash, and debt balances. Protects the buyer if the business's financial position at close differs from what was represented.

PE

(Private Equity)

Investment firms that acquire companies using a combination of equity and debt, with the goal of improving operations and selling at a higher valuation. In the lower middle market, PE activity is dominated by smaller funds and independent sponsors targeting businesses too small for larger institutional buyers.

Q

QoE

(Quality of Earnings)

An independent financial analysis that examines whether a business's reported earnings accurately reflect its underlying economic reality. A QoE evaluates the sustainability of revenue, the legitimacy of expense addbacks, working capital trends, and accounting practices. It is not an audit; it is an investigative analysis focused on economic substance rather than compliance. The primary output is an adjusted EBITDA figure the buyer can rely on for underwriting. See also: Buy-Side QoE, Sell-Side QoE.

R

Representations and Warranties

(Reps & Warranties)

Statements of fact made by each party in a purchase agreement about the condition of the business, accuracy of financial statements, compliance with laws, and other material matters. If a rep or warranty proves false after closing, the injured party may have a claim for indemnification.

Retrade

When a buyer renegotiates the purchase price downward after an LOI is signed, typically citing findings from due diligence. Retrades are common in lower middle market deals where the seller's initial financial presentation doesn't

survive scrutiny. A well-conducted QoE gives a buyer legitimate, documented grounds to retrade if the numbers don't hold up.

Revenue Quality

An assessment of how reliable, recurring, and sustainable a business's revenue is. High-quality revenue is contractually recurring, diversified across customers, and not dependent on one-time events. Low-quality revenue may be lumpy, customer-concentrated, or propped up by timing decisions that won't repeat.

R&W; Insurance

(Representations and Warranties Insurance)

An insurance policy that covers losses arising from breaches of representations and warranties in a purchase agreement. Increasingly common in lower middle market deals as a way to reduce escrow requirements and provide cleaner exits for sellers. Typically purchased by the buyer.

S

SBA 7(a) Loan

A U.S. Small Business Administration loan program commonly used to finance lower middle market acquisitions. SBA 7(a) loans allow buyers to acquire businesses with as little as 10% equity, making them the primary financing vehicle for search fund buyers and ETA entrepreneurs. The program has maximum loan amounts and eligibility requirements that affect deal structure.

SDE

(Seller's Discretionary Earnings)

An earnings metric used for smaller owner-operated businesses, typically below $1-2M in annual earnings. SDE adds back the owner's full compensation (salary, benefits, and personal expenses) to net income, on the assumption that the buyer will step into the owner's role. Unlike EBITDA, SDE does not normalize for a market-rate management replacement. See also: EBITDA.

Search Fund

A vehicle through which an entrepreneur raises a small amount of capital to fund a two-year search for a business to acquire, then raises additional equity to fund the acquisition itself. Search funds are a structured form of ETA, typically backed by a set of institutional investors who receive equity in the acquired business.

Seller Note

A form of seller financing in which the seller agrees to receive a portion of the purchase price in installments after closing, effectively lending the buyer part of the acquisition cost. Common in LMM deals as a way to bridge valuation gaps or supplement bank financing. Seller notes are typically subordinated to senior debt.

Sell-Side QoE

A Quality of Earnings report commissioned by the seller, typically before going to market. Designed to present the business's earnings in a favorable and defensible light and to reduce friction during buyer due diligence. A sell-side

QoE can be valuable as a starting point but should not be used as a substitute for a buyer-commissioned analysis. See also: Buy-Side QoE.

Stock Sale

(also: Equity Sale)

A transaction in which the buyer acquires the seller’s equity rather than individual assets. The buyer inherits all assets and liabilities of the business, including unknown or contingent liabilities. Sellers often prefer stock sales for tax reasons; buyers typically prefer asset sales. See also: Asset Sale.

T

Trailing Twelve Months

(TTM)

The most recent twelve-month period for which financial data is available. TTM is the standard earnings measurement period in LMM transactions. Because it reflects the most recent performance, sellers have an incentive to make the TTM look as strong as possible, which is one reason revenue quality analysis focuses heavily on this period.

Transaction Costs

Fees and expenses incurred in connection with an M&A; transaction, including legal fees, accounting fees, broker commissions, QoE costs, and financing fees. These are typically treated as one-time addbacks to EBITDA since they won’t recur post-close.

U

Unaudited Financials

Financial statements that have not been subjected to an independent audit. The majority of lower middle market businesses operate with unaudited financials, often prepared by a bookkeeper or outside CPA on a compilation or review basis. The lack of an audit is one reason QoE analyses are particularly valuable in LMM transactions.

V

Valuation

The process of estimating the economic value of a business. In lower middle market M&A;, valuation is most commonly performed using EBITDA or SDE multiples benchmarked against comparable transactions. Other methods such as DCF analysis or asset-based valuation are used in specific contexts but are less common as primary valuation approaches in LMM deals.

Value Creation

The post-acquisition improvement in a business's earnings, efficiency, or market position. For ETA buyers and PE sponsors, a defined value creation thesis specifying what will improve and how is a critical part of the investment case before acquiring any business.

W

Working Capital

Current assets (primarily accounts receivable and inventory) minus current liabilities (primarily accounts payable and accrued expenses). Working capital represents the cash tied up in day-to-day operations. Businesses with high working capital requirements consume more cash as they grow, which affects both valuation and deal structure.

Working Capital Peg

The target level of net working capital that the seller is expected to deliver at closing, as negotiated in the purchase agreement. If actual working capital at close is above the peg, the buyer pays more; if below, the buyer pays less. The working capital peg is one of the most frequently disputed elements of LMM purchase agreements and a standard area of focus in buy-side QoE analyses.

About QoEPro

QoEPro provides buy-side Quality of Earnings reports for independent sponsors, search fund entrepreneurs, and private equity buyers in the lower middle market. Questions about any of these terms in the context of a live deal? We're happy to help.

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