

# diamond willow

*Aligning story, strategy and structure to secure corporate financing*

## M&A Guide

A Practical Buyside Framework for Targets, Risk, Structure, Valuation, and Financing



Contacts

[diamondwillowadvisory.com](https://diamondwillowadvisory.com)

[company/diamond-willow-advisory-ltd](https://www.linkedin.com/company/diamond-willow-advisory-ltd)

[connect@diamondwillowadvisory.com](mailto:connect@diamondwillowadvisory.com)

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## A practical overview for Canadian business owners, executives, and their advisors.

Mergers and acquisitions (M&A) are one of the most powerful tools available to grow, de-risk, or ultimately exit a business. Done well, an acquisition can accelerate growth, deepen competitive moats, or unlock succession options that would be difficult to achieve organically. Done poorly, it can strain liquidity, distract management, and destroy value.

This note is designed to give buyers a practical framework for thinking about M&A: what makes a strong target, where deals can go wrong, how they are structured and financed, and how to assemble the right advisory bench. The lens is intentionally pragmatic and lender aware - geared towards the realities of bank and private debt markets that ultimately support the transaction.

## Target Qualities

Before thinking about price, it helps to define what a “good” target looks like - for the buyer, for lenders, and ultimately for the combined business.



### Strategic Fit

- **Clear rationale:** fill a product gap, expand geography, add capabilities, or consolidate a fragmented market.
- **Revenue synergy potential:** cross-selling to each other's customers, leveraging shared channels or brands.
- **Operational synergy potential:** shared overhead, procurement, systems, or facilities.



### Earnings Quality & Cash Flow

- Consistent, defensible EBITDA rather than one-time or volatile results.
- **Strong cash conversion:** limited leakage to capex, working-capital swings, or non-recurring items.
- **Transparent financials:** clean monthly reporting and year-end statements, and a sensible chart of accounts.



### Business Model & Revenue Profile

- Recurring or highly repeatable revenue, contracted backlog, or stable, long-term customer relationships.
- **Diversified customer and supplier base:** no single party representing an outsized share of revenue or margin.
- Defensible margins supported by brand, IP, relationships, or cost position - not just underpricing.



### Management & People

- Capable second-tier management, not just a single founder “doing everything.”
- **Cultural compatibility:** similar attitudes towards risk, customers, and people - important for post-close integration.
- Retention of key talent via employment agreements, equity rollovers, or incentive plans.



### Systems, Processes, and Governance

- **Basic scalability:** ERP/CRM, inventory systems, and controls that can handle growth.
- Defined processes in operations, sales, and back-office, not just tribal knowledge.
- **Governance-ready:** board reporting, KPIs, and documentation lenders can underwrite.

**Targets that score well on these dimensions are easier to finance, integrate, and grow - and typically command better valuations and terms.**

## Key Risks

Every deal has risk; the objective is to identify it early, price it appropriately, and structure around it where possible.



### Business & Market Risks

- **Cyclicality:** exposure to commodity prices, construction cycles, or specific macroeconomic drivers.
- **Customer concentration:** a handful of customers driving a large portion of revenue or EBITDA.
- **Supplier or key-partner risk:** sole-source inputs, critical distributors, or platforms.
- **Technology and obsolescence:** product lifecycles, R&D intensity, and competitive threats.
- **Regulatory and ESG constraints:** licensing, environmental exposure, safety profile, and reputational risk.



### Financial & Reporting Risks

- **Unreliable financial statements:** inconsistent accounting, aggressive revenue recognition, or weak controls.
- **Normalizations and add-backs:** excessive adjustments can mask the true, sustainable earnings base.
- **Working capital volatility:** seasonal swings or structural issues that require more cash than expected.
- **Off-balance sheet items:** leases, guarantees, contingent liabilities, or under-funded obligations.



### Deal & Integration Risks

- Overly optimistic synergy cases that require flawless execution.
- Cultural clash leading to turnover of key staff or customer-facing leaders.
- **Integration complexity:** overlapping systems, locations, and processes that are costly to rationalize.
- **Founder transition risk:** pace of handover, clarity of role, and alignment on post-close responsibilities.

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Good M&A processes surface these risks early, use them to refine valuation, and address them through structure, governance, and integration planning - **not by ignoring them.**

## Strategic Structuring Tools

Price is only one lever in a transaction. Structure can bridge gaps in valuation, allocate risk, and improve bankability.



## Asset vs Share Transactions

- **Share deals:** buyer acquires the corporation (including all assets, liabilities, and contracts) as a going concern.
- **Asset deals:** buyer cherry-picks assets and assumes selected liabilities; often used in turnarounds, carve-outs, and situations with legacy risks.
- Tax, legal, and commercial considerations often drive the choice – and it has direct implications for lender security.



## Earn-Outs &amp; Contingent Consideration

- **Earn-outs:** a portion of the purchase price is paid over time based on performance (EBITDA, revenue, or other KPIs/metrics).
- Useful when the seller is confident in future upside and the buyer wants downside protection.
- Must be carefully drafted to avoid disputes – clear definitions, reporting, and control mechanics.



## Vendor Take-Backs (VTBs) and Seller Notes

- Seller finances part of the purchase price via a subordinated note.
- Can reduce the immediate cash requirement and align the seller with future performance.
- Lenders will look closely at subordination terms, amortization, and any equity-like features.



## Equity Rollovers &amp; Management Participation

- Selling shareholders retain or re-invest into the new structure, often alongside a private equity sponsor.
- Demonstrates ongoing alignment and reduces the perception that the seller is “fully exiting.”
- Can be paired with management incentive plans (options, growth shares, or synthetic plans) to lock in key people.



## Reps &amp; Warranties (R&amp;W) Insurance

- Insurance policy covering certain breaches of representations and warranties in the purchase agreement.
- Can ease tension on indemnity caps and escrow amounts, particularly in competitive auctions.
- Often seen in sponsor-backed transactions and larger mid-market deals.



## Closing Mechanics

- **Lock-box vs completion accounts:** whether economics are fixed at a historical date (subject to leakage protections) or trued up at closing based on working capital and cash/debt levels.
- **Working-capital pegs:** ensure a “normal” level of working capital is delivered at closing; adjustments can be material.

Thoughtful structuring can turn a “stuck” negotiation into a **workable deal** while creating a package banks and other lenders can support.

## Valuation

Valuation is not just a number; it is a set of assumptions about earnings, risk, and growth, expressed in a price and a structure. The common vernacular is EBITDA but we look at free cash flow (EBITDA less required capital spending) as the true metric. For consistency, this report will use EBITDA, but buyers, sellers, and lenders should be considering free cash flow, not EBITDA.



### Normalized Earnings

- **Start with normalized EBITDA:** remove one-time items, owner-specific expenses, and temporary distortions.
- Validate earnings quality with trends by customer, product, and margin - ideally supported by external "quality of earnings" work.



### Multiple-Based Approaches

- **EBITDA multiples:** the most common approach in traditional mid-market M&A.
- **Revenue multiples:** more common in earlier-stage or high-growth sectors (e.g., SaaS) where current EBITDA understates long-term potential.
- Multiples are influenced by growth, margin level and stability, size, cyclicity, concentration, competitive position, and management depth.



### Intrinsic & Market Cross-Checks

- **Discounted cash flow (DCF):** useful to test whether the implied multiple is consistent with realistic long-term cash flows.
- **Trading comparables:** public company peers, adjusted for size and liquidity.
- **Precedent transactions:** similar deals in the same sector, adjusted for timing and specific deal features.



### Enterprise Value to Equity Value

- Enterprise value (EV) reflects the value of the operations, independent of capital structure.
- To get to equity value, adjust EV for net debt (interest-bearing debt less excess cash), surplus or deficit working capital relative to the agreed peg, and off-balance-sheet obligations and other specific items negotiated in the SPA.
- The headline multiple is less important than the full equity cheque required and the ability of the business to support the resulting capital structure.

**A disciplined valuation process helps avoid over-paying and sets realistic expectations for both buyer and seller when talking to banks and private lenders.**

## Bank Financing Goal Posts

Even the best-strategized acquisition can stall if it isn't financeable. Understanding lender "goal posts" up front is crucial.



### Leverage & Coverage

- Leverage: total debt / EBITDA and senior debt / EBITDA.
- Coverage: FCF / interest and scheduled principal repayments (i.e., leases, term debt).
- Repayment profile: ability to amortize senior debt within a reasonable time frame under base and downside cases.
- Banks will typically fund the lower of 60% to 70% of the enterprise value or 3x senior debt/EBITDA.

Higher leverage may be possible if earnings are stable, collateral is strong, and the sponsor equity cheque is meaningful.



### Equity Cheque & Risk Alignment

- Lenders want to see meaningful equity at risk from the buyer - commonly 10% to 30% of total capital in mid-market deals, depending on sector and structure.
- Equity can include common equity, preferred equity, and some forms of subordinated debt, but "true" cash equity is viewed most favourably.
- Rollovers and VTBs can help but rarely fully substitute for fresh equity.



### Security, Covenants, and Information

- Security: first-ranking security over operating companies, with clear collateral coverage (AR, inventory, equipment, real estate, and IP, as applicable).
- Covenants: leverage and coverage ratios, plus restrictions on distributions, additional debt, and acquisitions.
- Information: monthly reporting, covenant compliance certificates, budgets, and integration updates.



### Integration & Case Support

- Lenders will expect integration plans: how systems, teams, and processes will be combined, and what synergies are assumed.
- A robust financial model that shows base, downside, and integration-risk scenarios is critical.
- For more complex or leveraged files, banks may insist on co-lending with private credit or subordinated capital to keep senior leverage within their comfort zone.

**Understanding these goal posts early can save time, avoid dead-end negotiations, and help shape a capital structure that works for both borrower and lender.**

## M&A Advisors

Good advisors do more than “run a process.” They help you clarify objectives, avoid pitfalls, and align deal terms with long-term strategy.



### Core Advisory Roles

- **Corporate finance / M&A advisor:** helps articulate the strategic rationale and acquisition criteria, prepares financial models, valuations, and marketing materials, and manages outreach to targets or buyers.
- **Capital advisory / debt advisor:** designs the optimal capital structure (mix of bank debt, private credit, mezzanine, equity) and runs a competitive process with lenders.
- **Legal counsel (M&A and banking):** drafts and negotiates LOIs, purchase agreements, shareholder agreements, and credit/security documentation.
- **Accounting, tax, and diligence advisors:** perform quality-of-earnings reviews, working-capital analysis, and tax structuring, and support integration of accounting policies and controls.
- **Specialized advisors (as needed):** regulatory, environmental, HR, IT, or sector-specific experts.



### When Advisory-Led Processes Make Sense

- Competitive auctions or contested situations.
- Complex capital structures with multiple lender classes (banks, private credit, VTBs, rollovers).
- First-time acquirers or founders without in-house M&A teams.
- Distressed or time-sensitive transactions where missteps are costly.

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**The right advisors should not just “get the deal done,” but help ensure the transaction and financing align with your long-term strategy and risk tolerance.**

## The Bottom Line

M&A is a powerful lever to scale, diversify, and ultimately transition ownership – but it is also one of the highest-stakes decisions most business owners will ever make. The best outcomes combine:

- **Disciplined target selection rooted in strategic fit and quality of earnings.**
- **Clear-eyed risk assessment and realistic integration planning.**
- **Thoughtful structuring and valuation that align risk and reward between buyer and seller.**
- **Bankable financing that the business can comfortably support through cycles.**
- **Aligned advisors who understand both the deal and the capital markets that must support it.**

Handled in this way, M&A becomes another tool – alongside organic growth and capital investment – to help Canadian businesses scale, acquire, or turn around on their own terms.

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## Contacts

🌐 [diamondwillowadvisory.com](https://diamondwillowadvisory.com)

in [company/diamond-willow-advisory-ltd](https://www.linkedin.com/company/diamond-willow-advisory-ltd)

✉ [connect@diamondwillowadvisory.com](mailto:connect@diamondwillowadvisory.com)



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