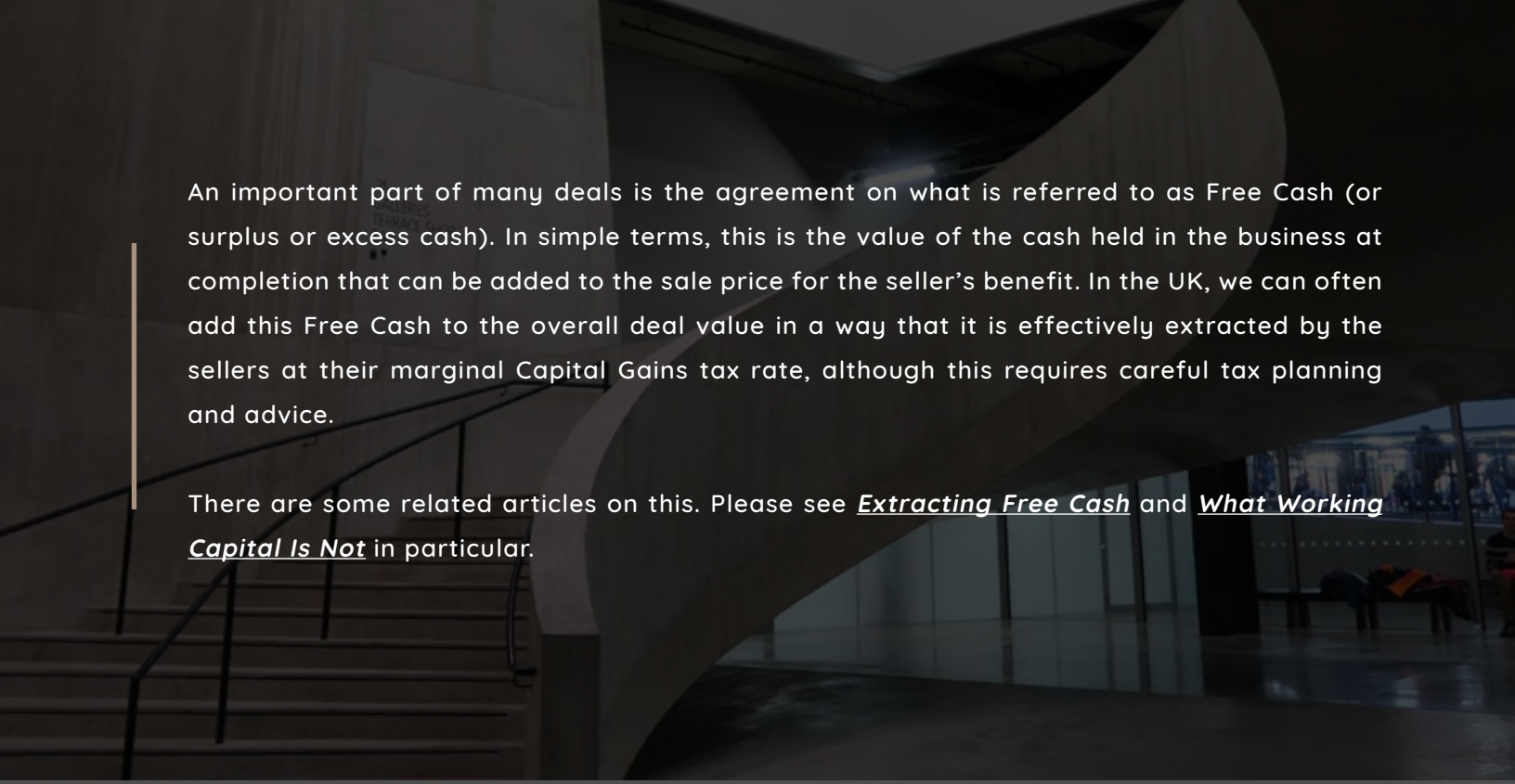




BENCHMARK  
INTERNATIONAL

# Cracking the Safe:

*Locked-Boxes Demystified*



An important part of many deals is the agreement on what is referred to as Free Cash (or surplus or excess cash). In simple terms, this is the value of the cash held in the business at completion that can be added to the sale price for the seller's benefit. In the UK, we can often add this Free Cash to the overall deal value in a way that it is effectively extracted by the sellers at their marginal Capital Gains tax rate, although this requires careful tax planning and advice.

There are some related articles on this. Please see [Extracting Free Cash](#) and [What Working Capital Is Not](#) in particular.

## COMPLETION MECHANISM

The traditional method of agreeing Fixed Cash involves the agreement between the buyer and seller of a number based on a set of completion accounts, prepared within an agreed period after completion.

The mechanism itself can be complex, including the agreement of a net working capital target to ensure the Free Cash number is fair to both parties. This means that the sellers are compensated for leaving an unusually high level of net working capital at completion, or that the buyer is likewise compensated if the level of net working capital left within the business is unusually low. Everything is worked out based on an agreed completion balance sheet and a pre-agreed net working capital target.

## LOCKED-BOX MECHANISM

Lately, it has become more common for the Free Cash number to be agreed ahead of completion, which allows both the buyer and seller to have certainty on the number and concentrate on running the business once the deal has been completed.

### THIS IS WHERE THE TERMINOLOGY STARTS TO GET INTERESTING:

**Locked Box Date:** The parties essentially perform all the analysis and negotiations around the Free Cash number, including agreeing on the net working capital target, at a date several months before completion. This date is usually chosen after the buyer has completed their financial due diligence and has a good understanding of the company's financial position. At this point, a number is agreed upon.

**Profit Ticker:** In a profitable company, a Free Cash number agreed at completion would usually be higher than one agreed at a Locked-Box date, as profits and cash will continue to accrue in the intervening period. The term used for the upward adjustment, which can be complex, is Profit Ticker.

**Leakage:** This term describes outbound company cash flows that would result in a downward adjustment to the Free Cash number. It is necessary to protect the buyer from unusual payments being made out of the company once the Free Cash number has been finalized. The most common adjustments are related to the payment of dividends, salaries, and capex over and above agreed amounts. The agreement of permitted leakages is a normal matter between both sets of lawyers and rarely causes significant issues.

#### WIN-WIN!

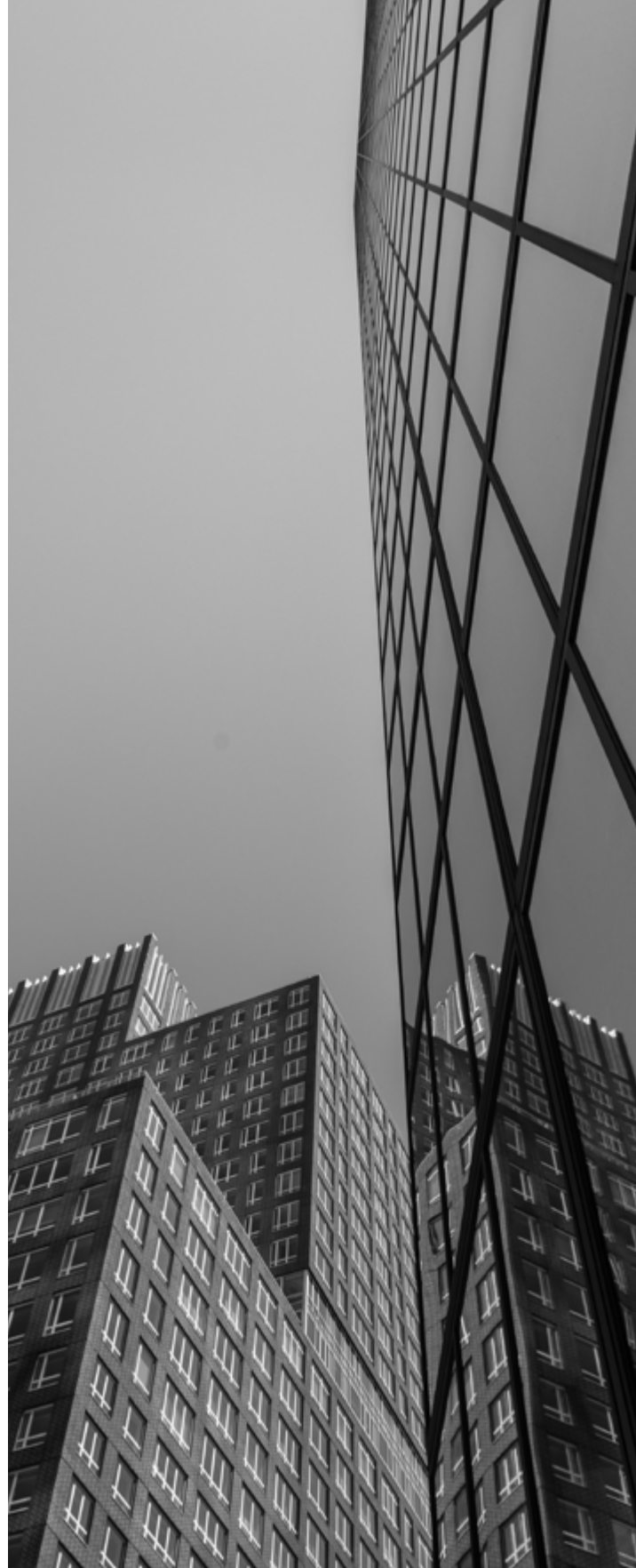
The use of a Locked-Box is a great way to ensure a degree of certainty around Free Cash before the completion of a company sale, benefiting all parties involved. However, there is always a degree of judgment involved, and for this reason, not all buyers will agree to this suggestion.

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