AM&AA
MidMarket talk
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JUNE/AUGUST 2020

CM&AA Virtual Starts Next Month—Register Today

CM&AA explains the fundamental concepts that define the Private Capital Markets and how those differ from the public markets and helps participants understand the connection between sources of capital, transfer methods, and valuation of a privately held business. The program is balanced with deep dives into legal issues, tax considerations and the due diligence process and ends with investment banking techniques to help achieve a successful deal closing.

CM&AA Virtual Dates:

July 14-August 18

Topics

- How Deals Get Done (Market Overview)
- M&A Process and Best Practices
- Due Diligence
- Financing: Growth & Acquisition
- Business Valuation
- Financial Analysis, Transaction Structuring, and Relationship to Transaction Pricing
- M&A Legal Topics
- M&A Tax Considerations
- Investment Banking Structuring Techniques

Onsite Classes

- October 5-9, 2020—DePaul University, Chicago Loop Campus, Chicago, IL
- November 9-13, 2020—Pepperdine University, Malibu, CA

Save the Date

Upcoming Chapter events for Q2:

June 10, 2020
Financing in the Defense and Government Markets in 2020—Broader Dislocation and Industry Opportunity

August 24, 2020
Southern Nevada Chapter Event

Dear M&A Professionals,

We hope you are safe and healthy during this unprecedented time. We remain committed to the M&A industry and as such, we have made the decision to make the **AM&AA Summer Conference a virtual experience, to be held on August 5-6, 2020.**

On behalf of the Alliance of Merger & Acquisition Advisors® (AM&AA) Advisory Council and our Conference Planning Team, I wish to personally invite you to join us. We expect another great showing of the middle-market community including investment bankers, intermediaries, private equity, corporate investors, lenders, CPAs, consultants, attorneys, Value Growth professionals, and other M&A experts.

Virtual does not mean less content, networking, or dealmaking. The 2020 AM&AA Summer Conference will feature panel video sessions with an interactive Q&A, a virtual expo hall and Deal Connect, as well as networking opportunities in the virtual attendee lounge and speaker and sponsor chat rooms. Attendees can also receive over 10 CPE credits.

We are committed to delivering the best conference experience you have come to expect and we hope you will join us for the first-ever virtual AM&AA conference on August 5 and 6.

Now more than ever, AM&AA is committed to supporting value-added opportunities to enrich our M&A community. I hope you will register today and join us in August for another unique experience, valuable deal-making, and growth opportunities to members and colleagues.

Until then, please take care and stay well.

David Asmus
Managing Director
CKS Advisors, LLC
2020 AM&AA Summer Conference Chair and Emcee

The Latest «««««

Capitalization 2.0—Terminal Value under changing capital structure

By Mike Adhikari, MBA Univ. of Chicago
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Terminal Value (aka Horizon Value) is the value of a firm when the firm is expected to grow at a constant rate forever. The method to calculate value a constant-growth firm is sometimes called Capitalization. Currently, and for decades, the primary method, if not the only method, to calculate Terminal Value is a formula commonly known as the Gordon Growth Model (GGM). In addition to the constant growth assumption, Gordon Growth Model assumes "constant capital structure" which results into "Constant WACC" (Weighted Average Cost of Capital) as a discount rate. This paper will show following: 1) The "constant WACC" assumption of the Gordon Growth Model implies that the capital markets will accept "Dividend First" financing terms. However, the capital markets function with "Debt First" financing terms. When a firm operates with "Debt First" financing terms, but the value is based on "Dividend First" financing terms, the equity IRR is less than expected. This means GGM overvalues a firm. And, such over valuation is material, 10 to 50% and sometimes even more. 2) Introduce Advance Growth Model (AGM) to value a constant-growth firm assuming capital markets acceptable "Debt First" financing terms. AGM formula is a generalized formula for Terminal Value; AGM value is equal to GGM value if GGM assumptions are plugged into the AGM formula.

GGM formula is very elegant; AGM formula is very complex even though it has only 3 more input variables. A free spreadsheet with GGM and AGM formulas is available at www.AltBV.com.

Pandemic slows deal-making for small businesses

By Ann Meyer. Originally published in Small Business Chicago

How much will your company be worth after the coronavirus pandemic subsides? That's the question advisers in the mergers and acquisitions industry considered Wednesday in a town hall presented by the Alliance for Mergers & Acquisitions Advisors.

Grocery retailers and their suppliers stand to fare better than restaurants and bars that were shuttered. But how well a business' valuation weathers this epidemic also depends on how soon the owners might seek a private equity infusion or a buyer, experts said. Most hoped the economy would pick up in the third quarter.

"I'm not sure we're going to get back for a while to the multiples we had. We have to figure out what is the new norm," said Roger Schoenfeld, managing director at Cross Keys Capital, an investment bank. "We won't know until the third or fourth quarter, except for food manufacturers."

More risk

If companies can hold out, their valuations might be less impacted. But certain industries will be perceived to have more risk, and the risk could reduce the "multiple" used to compute its valuation, Schoenfeld said.

A small company's cash flow or earnings before interest, taxes, depreciation and amortization (EBITDA) typically is multiplied by a number to determine its valuation, experts say. For companies under $10 million, the multiple might be three to five, while larger companies' valuations might be six to eight times EBITDA in a more typical environment.

When a prolonged crisis hits, a lower multiple might be used, Schoenfeld said, reflecting the hesitation in the market to complete an acquisition.

In the food industry, the opposite effect could occur where grocers and food-manufacturers see their revenue and earnings drop off after restaurants re-open, enticing more consumers to eat their meals away from home.

"There's a lot of uncertainty, and uncertainty is very difficult in the M&A world," Schoenfeld said.

Lindsey Wendler, managing director of National Transaction Advisors, a Riverbend company, moderated the discussion April 23, asking the panelists how they communicated with their client companies and what the top concerns were. Most said they were communicating more often with owners, including taking calls evenings and weekends.

Case-by-case basis

The panelists said the pandemic's impact must be determined on a case by case basis. Jay Freund, managing director of Stratford-Cambridge Group, said the factors he considers most important are the steepness of "the cliff," before a company runs out of funds, and the speed at which it can recover.

Businesses that have closed their doors and furloughed employees could feel the impact more than business-as-usual companies or those that have picked up sales, such as food companies and online merchants selling essentials.

Many firms in the private equity field itself have gone into an emergency mode, where staying connected with clients is more important than trying to get deals done, the experts said.

Stratford-Cambridge, a private equity firm specializing in industrial mid-market companies in the Midwest, is emphasizing the welfare of the employee base at its client companies, Freund said.

"With the hesitation that's generally out there right now, we at Stratford-Cambridge put a bid in on Monday but we caveated it," he said. "We need to convince ourselves it has some form of sustainable cash flow and that it's viable."

Cutting expenses

Some companies have begun slashing expenses and hoarding cash to bolster their net income, but it's too soon to understand the longer trend given the uncertainty over how long the crisis will last.

"Underwriting is a challenge," said Dan Harvey, senior vice president at Wintrust Commercial Banking.

The lower valuations are, the more opportunity some buyers might find in the market. But activity is being curtailed in part due to a tightness in bank loans. "Instead of trying to get maximum leverage on a deal, there might be a more conservative approach," Harvey said.

"Banks have been focused on PPP and other programs," Harvey said, referring to the government's Payroll Protection Program that quickly ran out of the initial $349 billion in funding. The U.S. House is expected to approve $484 billion in appropriations for small businesses and hospitals soon, which the Senate approved Tuesday.

Loan forgiveness

The PPP program will forgive the loan if 75% is used for payroll and the rest is used for rent, mortgage and utilities. But the employer must maintain workers at their salary levels or quickly rehire them for the loan to be forgiven. The 1% loan matures in two years for companies that lay off workers or cut wages.

But obtaining a PPP loan is a problem for companies that didn't act fast because demand has exceeded supply. Citibank has stated on its website:

"We know the news that the Small Business Administration (SBA) has fully allocated the $349 in funding for the Paycheck Protection Program (PPP) is hard for many to hear. However, in the event that additional funding will be approved, we are diligently processing the applications that have already been submitted and accepting applications from our Small Business Banking clients…. We will hold on to applications for processing for up to 30 days, in the event that additional funding does become available."

Employee furloughs

Freund said Stratford-Capital has furloughed employees at the companies it invests in. "We have communicated we expect it to be temporary," he said, noting employees are still receiving health care benefits. "If we can't get them back, it could be an issue."

Besides retaining employees to prevent the loss of talent imperative to a company's valuation, the experts said keeping workers employed is important to the economy. According to a report this month from the St. Louis Federal Reserve Bank, the losses due to COVID-19 in the hotel and food service sectors will be about 30% higher than initially predicted because of the ripple effect on suppliers.

Those industries employ a large number of workers who when furloughed are expected to cut back on spending.

"Unfortunately, a lot of consumers live paycheck to paycheck, so getting consumers back to work is the most important indicator in my mind," Schoenfeld said. "The economy is driven by consumer spending. People need to get back to work and get a paycheck. The less discretionary income they have, the less they spend."

> "I'm not sure we're going to get back for a while to the multiples we had. We have to figure out what is the new norm."
>
> —**Roger Schoenfeld**, managing director at Cross Keys Capital

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We are accepting articles from AM&AA members that are educational in nature and average 1200 words.
Email Catleah Capuli with your interest and topic: ccapuli@amaaonline.org

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Let's Make Middle Market News Together.

AM&AA thanks you for supporting the launch of M&A Access, your middle market news.

What's Our Goal?

The world continues to cope with the COVID-19 pandemic. Our platform and guests have and will continue to keep you up-to-date on how the pandemic has affected our industry. Beyond the coronavirus, M&A Access is your source for economic updates, industry reports and interviews with high-profile sources covering all aspects of the mergers and acquisitions world.

Access Granted

You have the power to not only rely on M&A Access but to be a part of it. You can be our next guest! Get your name and face out there and show off your industry expertise to the world. Interested? Contact Catleah Capuli at ccapuli@amaaonline.org.

We're two months strong and counting. Some of our past guests include:

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Chris Blees, BiggsKofford Capital
Taylor Devine, The CDI Group
Terence Hannafin, Carter Morse & Goodrich
Lindsey Wendler, NTA-Riverbend
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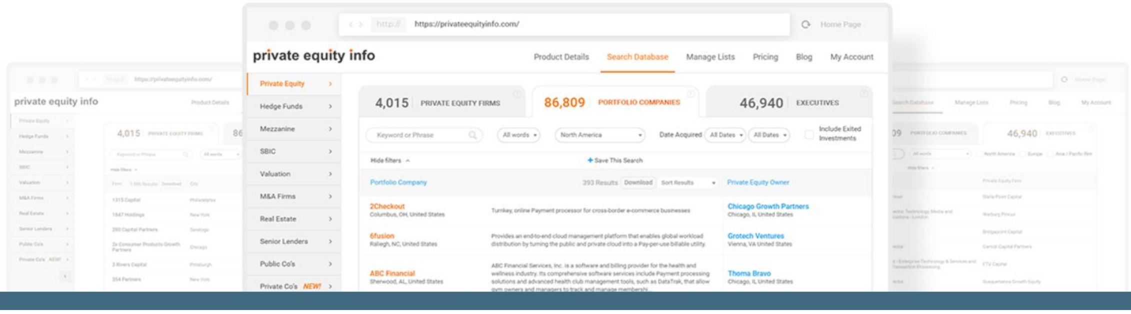

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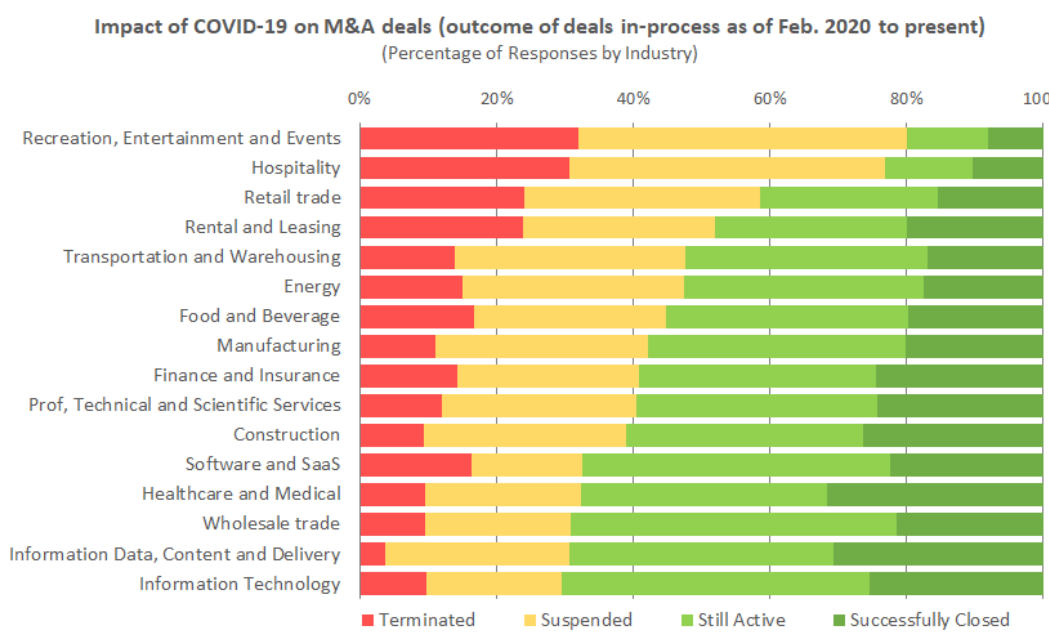
AM&AA 2020 M&A Market Report

AM&AA has just completed its 2020 M&A Market Survey. Initial findings show the impact of COVID-19 on M&A deals, by industry, varies between 30% to 80% (please see below). As an exclusive benefit, AM&AA Members will receive the full comprehensive report so please stay tuned for more valuable insights and findings coming soon.



All AM&AA members and participants will receive the full market report when it is complete; a high-level version will also be released with an overview of key takeaways from the 2020 market survey.