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FALL 2020

Optimism During Uncertainty

Dear Colleagues,

Writing this letter affords me the opportunity to pause and reflect on these last months, and it is amazing what this time has brought.

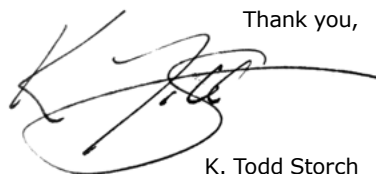
Q2 introduced a season of local, national, and global uncertainty that most haven't seen or experienced before, and as we approach the tail-end of this year, there's still a great deal of change ahead of us. While there's quite a bit of unpredictability left, the future still holds opportunities for optimism and success. We've even seen a sense of rallying, glimpses of a returning to what we used to call "normal," development and accelerations of technical adoption, and the resiliency of growth markets.

From its conception, the AM&AA was founded on the principal of creating educational opportunities for the betterment of the M&A community. We're a group that is built for teamwork and collaboration. Our efforts are not only fueled by growth metrics, but of partnerships and relationships that are unique to our industry.

In recent years, the AM&AA went through a series of transitions that we believe strengthened our core membership and offerings. This year I joined Five Star Global as CEO. I am honored and thrilled to be a part of such an incredible community. I have a passion for leadership that looks through the lens of servanthood and will continue to make that the North Star as we serve our M&A community.

My business and personal life are framed and guided by a phrase that my grandfather taught me: It isn't what happens to you that matters, but how you react to it that does. This year has been a whirlwind of change, and our M&A community needs us now more than ever before. We each have an opportunity every day to make positive steps and decisions as we move forward and lead during uncertain and unpredictable times. As Chris Blees, our Council Chairperson stated in the Q1 newsletter, the companies we serve are the lifeblood of the world's economy. The opportunities our members create on a weekly basis play a profound role in the survival and recovery of our economy; and towards this goal, the AM&AA is honored to be a resource for you.

Thank you,



K. Todd Storch
Chief Executive Officer



Positioning Your Company for Sale or Recapitalization

By Roger Schoenfeld and Ross Schoenfeld

Many business owners contemplating a sale or recapitalization of their business have experienced a disruption to their plans in the wake of the COVID-19 health and economic crisis. Business owners are facing increasing day-to-day challenges managing business operations through the constantly evolving environment.

If you have the crisis stage of the current economic situation under control and are considering selling or recapitalizing your business in the next few years, this could be a good opportunity to use some of your spare time to create a strategy to best position your company for sale in the future. Doing so will likely increase your business enterprise value when the timing is appropriate for you and your stakeholders to sell your business.

Take Steps to Increase Enterprise Value

Enterprise value is driven by several factors, including the positive attributes and risks in your business. Identifying the strengths in your business model and creating strategies to mitigate operational risks will enhance your enterprise value from the perspective of a potential suitor. One common risk found in businesses is concentration of customers, products, services, or suppliers. Taking steps now to diversify concentrations in any of these areas will reduce the risk of suitors discounting the valuation of your business during a transaction process.

Another operational risk that is common is a concentration in responsibilities in

the business owner. Identify what you do as an owner and what key customer and vendor relationships you hold. Ensure that your business is not overly dependent on you and your relationships going forward. This reduces the risk in completing a sale transaction, as potential suitors focus on minimizing disruption in a business ownership transition. Consider adding other team members to those key relationships so that there are multiple points of contact at your company. Bring others on your team into key decision making. If you do not have a management team, consider creating one and giving other management members more authority. Private equity buyers are especially interested in companies with strong management teams and quite often provide future equity opportunities for management team members.

Identify Potential Suitors for Your Business

Another important exercise is to determine who the best buyers or groups of buyers might be for your business. Consider what they would likely deem to be the most

valuable attributes in your business as an acquisition target. Include in your pre-sale plans ideas to make your business more attractive to those potential buyers. In many circumstances, the best buyers for a business are those with common synergies where an acquisition is accretive to their business and where one plus one is considerably more than two. When identifying potential buyers and buyer groups, consider companies like yours as well as other companies that may not overlap perfectly but that have common customers, sales channels and/or products and services. In many cases, completing a transaction with these other companies that are not directly competitive with your business is less risky and more likely to be successful.

If you have a longer time horizon, considering acquiring another business or product/service line to increase your enterprise value. Doing so could help you diversify your business (as noted above) and grow revenues and profits. In almost all cases, businesses with higher revenues and profits are valued at higher valuation multiples than businesses with lower revenues and profits.

Discuss Personal and Financial Goals with Trusted Advisors

One of the key steps in going through a sale process for your business is to identify your personal and financial goals for the transaction. Planning well in advance with a trusted advisor and significant other in your life will help you identify these primary transaction goals. While maximizing net proceeds is a goal of many business owners, other goals may be more personal in nature when dealing with lifestyle and retirement matters. It is also important to consult your tax and financial advisors to make sure your company is positioned to complete a transaction in a tax-efficient manner.

Business owners should be consistently refreshing the long-term strategy for their business. Planning for a sale or equity recapitalization transaction can better position a business to act efficiently and attract higher enterprise valuations, when the timing is appropriate.

An important part of the sale process is the identification of transaction goals and the creation of a robust list of potential synergistic suitors in order to find the right buyer for your business.

Finding the right buyer will create a win-win situation where you can maximize your enterprise value and provide for a successful transition of ownership and bright future for your business.



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Capital and can be reached at 847.732.9715 or ross.schoenfeld@ckcap.com. Cross Keys Capital is a boutique investment banking firm providing merger and acquisition advisory services to owners of established privately held businesses in the lower middle market with enterprise values from \$5-\$100 million. They represent owners in acquisition, merger, sale and equity recapitalization transactions, including growth capital. Cross Keys Capital has 24 professionals and offices in Fort Lauderdale, Florida and Chicago, Illinois and has closed 135 transactions since 2010. For more information on Cross Keys Capital visit CKCap.com.

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Technology's role in today's business continuity strategy and a value provider in the M&A market

By Allen Amun

Often an overlooked yet vital component to a merger or acquisition transaction is the technology integration. Technology issues are the key component that can make or break deal value. As the dependency for organizational and infrastructure operations become more and more dependent and intertwined with a company's technology readiness it impacts and influences sustainability, productivity of human resources as well as integration with customers and support services. As a technology consultant specializing in M&A and Dives-tures transactions. I have seen companies lose substantial value, capital, and productivity by not accurately assessing the current state of the technology capabilities of the target organization during the due diligence phase. Most often technological designs, support contracts and capabilities are not required data room due diligence documentation, but I believe it should be standard operating procedure.

The current Covid-19 conditions have revealed the impacts on organizations that were not able to move swiftly and implement a business continuity plan. Where in the past business continuity in IT meant geo redundancy or some form of load balancing in the event of an outage or disruption to normal services, we see it also means being able to transition operations over multiple platforms such as cloud services, wireless devices and data aggregation and security. The new mobile/work from home model will be the new normal for the immediate foreseeable future as companies mitigate liability to exposure of the new novel coronavirus to resource; additionally the model has been proven on a global scale that people can work remotely and perform at the same or higher rate of proficiency.

Organizations that are weighed down with legacy systems or do not see the value in investing in new technologies that are cloud based, secure and remote manageable will expose themselves to risk and jeopardize revenues reacting to a crisis instead of being proactive from the onset. Any potential investor involved in a large or midmarket transaction should give this considerable examination, failure to do so risk actualizing a reasonable return on their investment.

Although valuation can tell you the assets, earnings, and market value of a potential target; it does not tell you it's sustainability or viability from an operational day two perspective after acquisition.

A few factors to consider are:

- 70% of technology integrations fail in the beginning of a transition, not the end
- There is a lot of money at stake: More than 50% of business synergies are technology-enabled
- A clear cost-management process is required to avoid cost proliferation throughout the integration

I have personally witnessed organizations blow through millions of dollars in IT operational budgets due to poor or no assessments and planning of IT infrastructure status.

Loss of 50% of value in an IPO due to inability to fully serve the market as the new entity, due to IT incapability, and under qualified and understaffed IT resources.

To mitigate these risks a strategic lens and planning must be applied to post-merger technology integrations at the onset to tackle the most critical technology priorities to guarantee efficiency and scalability to meet an ever changing and demanding business landscape.

In yesterday's world 10-year-old technology was outdated; in today's world five-year-old

technology is a dinosaur. Previously an organization could lag along with end of life equipment, currently it is harder and harder to find support for or replacements for such devices. Having weak or no assessment management could mean hundreds of thousands to millions of dollars in hardware replacements, licensing fees and penalties; a potential unforeseen expense inherited by an unsuspecting buyer.

Inconveniencing customers and delayed customer support are a common issue from poor end to end technology planning and integration; undermining sales, customer and or consumer confidence in the new entity and its management. Most times due to redundant or incompatible IT platforms and under trained support.

Industries that tend to maintain and employ robust technology infrastructure that can interact with customers over multiple web-based platforms and support staff are flourishing in the current pandemic such as:

- logistics
- healthcare
- IT/software
- gaming/entertainment

The industries hardest hit and are seeing a significant drop in revenue (although are traditionally more brick and mortar and require on-prim customer interface) tend to be the least technologically enabled or ready, such as:

- food services
- leisure
- retail
- construction
-

Amazon has seen extraordinary growth providing services for food and retail orders and deliveries to its customers while its competitors are closing weekly during the pandemic due to a reluctance to change from a brick and mortar based business

employing minimal operational technology. Amazon has proven that the utilization of technology as operational support and a virtual marketplace is that technology is a more of a value add than an expense.

In modern M&A transactions, technology should be considered as a necessary component and of value. It is the driver for:

- Expanding the customer base in existing markets.
- Pursuing cost synergies or scale efficiencies.
- Entering new markets.

Each acquisition, buyout, add-on, capital investment transaction a fund chooses to invest in on day one, should ask the question am I planning toward the connected technologically based investment model of today or the risked based manual model of yesterday; make no mistake that differentiator is continuity of business through technology.



Allen Amun, CM&AA, is a 25-year IT veteran starting out in Seattle WA, during the dot

com boom. He is the CEO of Amun Industries a 15-year-old boutique consulting firm based in metro Atlanta. The Amun Industries team are experienced and successful experts at providing advisory and consultancy services in transformational ventures centered around mergers and acquisitions, divestures, and offshore/outsourcing initiatives. They specialize in developing and deploying projects for IT help desk, cloud, data center, infrastructure, infosec, network/voice, software, and system upgrades, integrations, migrations, and artificial intelligence and chatbot services.

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EBITDAC in the Transaction Process

By Kenneth H. Marks and Buddy Howard

One of the most often used metrics to value a private middle market business is EBITDA, which is earnings before interest, taxes, depreciation, and amortization. EBITDA approximates cash flow (albeit on a pretax basis), which is the ultimate value driver for a business. One variation of EBITDA is adjusted EBITDA, which attempts to normalize "cash flow" by eliminating unusual, owner-related or nonrecurring items. Normalized EBITDA attempts to eliminate the financial noise and peculiarities of privately held companies in both the sell-side and buy-side transaction processes.

With the onset of COVID-19 and the associated economic shutdown, there has been a significant impact on most companies' revenues, earnings, and EBITDA. While some businesses (such as the eat-at-home food industry, telehealth, communications, etc.), have "benefitted" from COVID-19, many companies have had severe negative effects from the pandemic. As a result, there has been an increasing trend to use a third, new metric: EBITDAC, for valuation purposes. EBITDAC is defined as the traditional normalized EBITDA measure except that it eliminates COVID effects, thus addition of the "C".

What are those COVID-19 effects and how do you measure them? For many companies, the most immediate impact has been on revenues. Lost sales from closures, displaced key personnel, lower demand, as well as potential pricing concessions and order cancellations have all contributed to drops in companies' revenues.

That loss of revenues often has a disproportionately negative affect on EBITDA since many expenses (rent, utilities, etc.) stay the same even on the lower revenues. Revenues may

be off by 20%, while EBITDA may decline 50% to 60%, or even become negative.

There are a couple of ways to adjust EBITDA to derive a more "normalized" EBITDAC. One approach is to show the hypothetical (pro forma) revenues using the year-ago figures instead of the COVID-affected ones, possibly even adjusting for the pre-pandemic growth trends. For example, in arriving at normalized six-month revenues as of June 30, 2020, one could take the first two months of revenues from 2020, and add the revenues from March 1, 2019 through June 30, 2019, as adjusted for the growth that was evident from the first two months of 2020 relative to the year-ago numbers. In other words, if the revenues in the first two months were up 10%, one could increase the March 1, 2019 through June 30, 2019 revenues by the same amount and add this to actual revenues for the first two months of 2020. A more conservative approach would be to simply add the year-ago revenues without the growth. Also, try to identify/footnote your assumptions to ensure better

transparency.

On the expense side, the best approach is often to multiply the pro forma level of revenues by the historical percentage of revenues that each expense represents. So, if general and administrative expense have historically been 20% of revenues, that is the percentage used on the pro forma revenues. Either way, the objective is to estimate what the financial results would have been had COVID-19 not existed.

Assuming a vaccine is discovered and life returns to something resembling "normal" in the next year or two, the differences between EBITDA and EBITDAC will likely diminish in future periods, with 2020 (and possibly 2021) being the year(s) where there are the greatest differences. But the point is that during these interim years, using a measure that shows the normalized cash flow of the business can be critical from a seller's standpoint.

Finally, it is often useful to show traditional measures such as EBITDA along with these new measures such as EBITDAC. In

addition to quantifying COVID's impact, tracking both will better measure the company's progress as it returns to a normal performance.

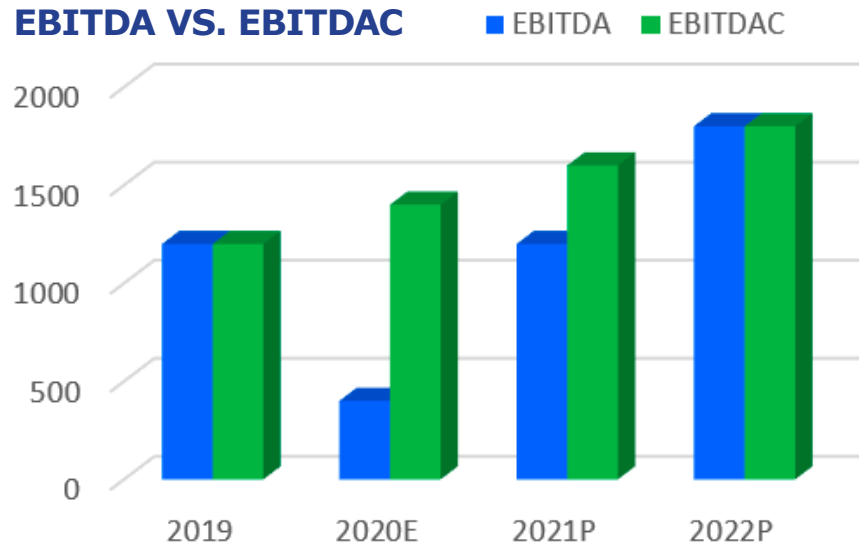


Kenneth H. Marks, CM&AA, CFA is the Founder and Managing Partner of High Rock Partners, Inc. **Buddy Howard, CFA, ASA** has more than 30 years' experience as a valuation



and financial analyst. High Rock Partners is a boutique firm of strategic and M&A advisors, located in Raleigh, North Carolina (in the RTP area), serving leaders of emerging growth and middle market companies. They assist owners and management in selling their company making acquisitions; making key strategic decisions; navigating and executing on transitions of ownership; accelerating growth to the next level; and to re-position their company to optimize performance.

EBITDA VS. EBITDAC



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Value Creation: A Paradigm Shift

By David Prowse

Many entrepreneurs start their business out with one focus in mind—growing profits and minimizing taxes. In the early stages of a small business (that oftentimes more closely resembles a job rather than an enterprise), entrepreneurs first worry about gaining traction with revenues and secondly after-tax earnings. Even as the business grows from a “main street” business to the lower middle market, this mindset of after-tax earnings is pervasive with most entrepreneurs. For a lifestyle business owner (happy with the current size of the business), this mindset may suit them well, as the perception may be there is no need to fix something that is not broken. But as your company continues to grow, so does its complexity. And as you age, the need to think about harvesting the wealth in your company becomes paramount since such a large percentage of your personal wealth is tied up in the business. This is where a value creation mindset can help you achieve your personal, financial, and business goals.

The Income Mindset Versus One of Value Creation

When one employs a value creation mindset, they are expanding beyond the idea of a business simply being a job but rather it becoming an entity that has multiple stakeholders such as family members, employees, suppliers, customers, along with the local community in which the company resides. Under a value creation mindset, decisions are not just made for the sole benefit of the owner or their immediate family but are taken with consideration of other stakeholders. Financials transform from a backward-looking tax-driven exercise done solely for compliance to a forward-looking exercise performed to create visibility and help provide owners with foresight.

In addition, cash flow (rather than net income after tax) becomes the primary driver of business decisions since it is the true key to understanding and managing value. Under a value creation mindset, projects become processes, since there

are always action steps that can be taken to improve a business. While planning is still important under a value creation mindset, action and relentless execution are the cornerstone to accelerating value over time. As a complement to this, measuring your results consistently, learning from that data, then pivoting based on that new information is the cornerstone to increasing shareholder value.

An income-oriented mindset focuses more on the here and now which can lead to short-term decision-making that temporarily can improve results but will destroy value in the long-run in the long run (for example, a failure to invest in more efficient machinery or strong key personnel). A value creation mindset, on the other hand, may forego immediate benefits to create efficiencies and strategic advantages that may only accrue in the future. When later selling your business, due diligence will shine a light on these oversights, which may ultimately impact the valuation or even the transferability of the owner's business in a negative way.

Transferability: Infrastructure & Process

Every owner has potential multiple exit options theoretically available to them but the more economically strong a business, the more options available to an owner. One of these options may be to keep the business since the owner has found renewed vigor in running a now successful and satisfying business enterprise. More options mean the owner has more leeway to achieve their goals whether they be financial (maximizing after-tax cash on the sale of a business), business (growing the business to be No. 1 in its class in the geographic region), or personal (consideration for family members involved in the business).

Companies with transferability have certain key characteristics:

- The company itself has processes that are independent of the owner, thus allowing the owner to take a step back while the company continues to generate profits.
- The company's processes

allow for repeatability. This means that employees can be trained to perform tasks and processes that have been shown in the past to achieve certain business objectives.

- The company has an adequate infrastructure to support the organization in achieving its objectives.
- The company has written short, intermediate, and long-term goals that are reviewed on a periodic basis.
- The company monitors its progress in achieving these goals through using key performance indicators that are tracked and reviewed in a timely and consistent basis.
- The company has visibility in its financial position (especially in its cash flows) and operations (production bottlenecks can be avoided).

Owners should be incentivized to review the above list and start implementing these today if there are shortcomings.

Value Creation—Growth vs. Succession

Does value creation matter if you are more of a growth-oriented owner versus one geared toward transitioning your business either internally or externally? What about owners looking to exit as soon as possible? Can a value creation mindset help them? The answer is yes to all the above. Let's look at this in more detail.

Every owner will eventually exit their business, whether it's voluntary (sale, internal transfer, orderly liquidation) or involuntary (forced liquidation, death, shareholder dispute, divorce). Thus, the question for any owner is when will they transition out of their business, how much control will they have over this process, and what after-tax value will they extract upon transition? Some of this risk can be mitigated through a strong shareholder's agreement (which can address issues such as divorce, shareholder dispute, and shareholder death). Notwithstanding these situations, both growth-oriented and exit-oriented owners are differentiated by the timing of their exit. A growth-oriented owner may today have no compulsion or interest in transitioning their business to others, but a value creation mindset is important

if they wish to scale up the business since an infrastructure and supporting processes are required to create sustainable growth. An owner more interested in exiting their business is motivated to maximize their after-tax proceeds from the succession of their business, something that can best be accomplished through growing and monitoring the value of the business over time. Even the sell now owner who is highly motivated to move on from their business as soon as possible can put some window-dressing on their business and increase its value and transferability.

One of the primary advantages of a value-creation mindset versus an income-oriented one is that once you understand the true power of value creation, the entrepreneur's mind can open to the vast business possibilities for their business. For example, organic growth can often be difficult even for large, public companies. This is what fuels the M&A market as companies seek growth through acquiring other businesses. Other possibilities include licensing intellectual property; engaging in alliances, partnerships and joint ventures; or creating new product or service lines based on customer-facing feedback. The key takeaway is that once you understand the true value-drivers of your business, opportunities to grow your business may present themselves in unforeseen ways.



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