Seale & Associates

MOST COMMON COVID 19 M&A QUESTIONS

By Brett Carmel, Senior Managing Director & Co-Founder

Did I miss the window to sell my business?

There is no "one size fits all" answer to this question. In a crisis, there are businesses that benefit and others that struggle. If your business is performing well and/or requires capital to take advantage of an opportunity, then a sale of equity (full or partial) or a recapitalization transaction still can make sense despite the economic uncertainty. For example, we have a client that offers on demand delivery for groceries and take-out meals. They have unprecedented demand but insufficient capital and infrastructure to take advantage. Not surprisingly, we have several strategic partners and financial investors who are interested in exploring a transaction. On the other hand, we have a client with high debt struggling with a significant decline in sales and negative cash flow. In this case, we are exploring a recapitalization and/or distressed sale as bankruptcy remains a credible near-term risk. While the current situation is challenging given overall uncertainty, we still hear frequently from interested buyers with capital - both strategic and financial - who are eager to invest or acquire for the long-term. Regardless if the timing is right for your business, the important point to remember is that a well-managed sale process takes time to close (4 to 8 months) and there is considerable up-front work to prepare properly. A company seeking flexibility to sell at some point in the future can start preparing now so they are ready to initiate a disciplined process when the timing is right.

What are the main challenges for a sale process?

The COVID crisis continues to have a significant impact on the global economy with difficult to predict ramifications for every sector. The uncertainty is compounded by actions taken (and yet to be taken) by governments to contain the spread of the disease. Further, access to liquidity remains a challenge. This has important implications for those interested in initiating a sale process since the net result of all these variables is a fundamental lack of clarity on how the business will perform in the future. As such, the valuation of a business – which is primarily based on expectations of future cash flows – is more challenging. Given the divergence in risk perception and lack of clarity, there will likely be a wider bid-ask spread on valuation. Sellers will tend to have a bias towards a more positive future with a quicker return to normalcy. Buyers will naturally assume there is greater downside risk and a more delayed timeline to recover. Hence, agreement on valuation may not come easy. However, if the business is performing well and/or has a strong story on why it will recover quickly post-crisis, then there are ways to narrow the valuation gap and design a creative transaction structure (i.e., earnouts, seller notes, performance based payments, and other risk/profit sharing mechanisms) to allow the parties to reach a mutually beneficial deal.

What can I do now to prepare to sell in the future?

It is important to understand that the impact of COVID on financial performance is extraordinary. Hence, how a business performs financially during this crisis will need to be adjusted and normalized for purposes of any valuation exercise. As a popular meme going around illustrates, we need to evaluate EBITDAC - or earnings before interest, taxes, depreciation, amortization and COVID. Valuation is driven on the expected future cash flows generated under normal conditions – not during a crisis. Since valuation will be based on normalized and adjusted financial performance, don't place undue emphasis on short-term profitability (or a lack thereof). The important thing is to survive and be ready to thrive when the crisis recedes. As such, make sure your business is well capitalized to withstand any demand and supply shocks. Once you have fortified the balance sheet, the focus can shift to being well-positioned to take advantage of the opportunities that will arise once the crisis is over. Short-sighted decisions can often have meaningful long-term impacts on a future sale process. It is important to retain quality human talent; maintain assets and foundational infrastructure; and protect customer or vendor relationships. This crisis will pass and when it does you want to be well-positioned for the future with all your stakeholders.

What near-term opportunities are available?

For those fortunate to have excess capital, a crisis generates opportunities. If you own a business, then consider hiring "superstar" employees that were laid off or furloughed; buying discounted assets in distress/bankruptcy situations; or negotiating better pricing or terms on inputs from key suppliers/vendors by paying up-front. There is also an opportunity to seek out distressed or undercapitalized businesses that must sell equity or assets given their challenging circumstances. There are also businesses performing reasonably well - or likely to recover quickly - where the owner may want to sell for personal reasons. This can result in acquiring a great business at a more attractive valuation considering the perceived risk and uncertainty. While many owners think selling must be an "all or nothing" transaction, there are many alternatives in between. For example, a business with short-term liquidity challenges can be recapitalized in return for equity ownership (majority or minority) and/or plain vanilla bridge loans. Another option is to consider convertible loans, which offers the investor the chance to convert the debt into equity at an attractive valuation with greater upside once the business recovers. As businesses struggle to overcome the challenges associated with the crisis, those with access to capital can play a constructive role in helping these businesses survive and later thrive once the economy returns to some semblance of normalcy.

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