

Sabal Advisors

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Insight Minute for Business Owners



Valuation Multiples and Deal Structure in Today's M&A Market

In today's M&A market, more than ever, valuation multiples, consideration structure, deal terms and closing time are specific to the company and the industry.

It could be considered a "tale of two companies." One company with operating results not impacted by COVID-19 sells at the same valuation multiple or higher as it would have pre-COVID-19 with the same or similar consideration structure, while another company with financial performance negatively impacted by COVID-19 sells at a reduced valuation multiple with a 3-year earn-out component. For example, e-learning, cybersecurity and janitorial supplies vs. travel services or restaurant supplies.

The M&A lower middle market is still digesting the impact of COVID-19, but certain changes have already happened and others are still expected. Deal making practices are very fluid and could change quickly.

Recent and expected changes include:

- Overall lower valuation multiples due to decrease in debt leverage, lower financial performance, lack of visibility with future earnings and COVID-19/economic uncertainty
- Increase in use of seller notes due to decrease in debt leverage and desire for more liquidity at transaction closing
- Increase in use of contingent earn-outs due to lack of visibility with future earnings or to bridge valuation gap between seller and buyer
- Increase use of subordinated debt in the capital structure due to bank leverage decrease
- Elongated due diligence period (an additional 30-60 days) due to buyer/lender's desire to see more current operating results, additional financial modelling scenarios, and work from home/travel concerns
- No noticeable increase in distressed deals yet, perhaps due to government stimulus extending the ability of companies to operate and banks being more patient.

It is still a seller's market for companies with continued strong operating performance. In many other cases, buyer creativity and seller flexibility will be key to completing a transaction.

COVID-19 Impact In Lower Middle Market Transactions (\$10m to \$100m deal size)*

| COVID-19 Impact | Valuation Multiple | Deal Structure | EBITDA Confirmation |
|--|---|--|--|
| <i>Neutral to positive impact on operating results, visibility to future performance</i> | No impact to a 1/2 turn reduction and perhaps an increase in certain situations | Larger deals may have increase in seller notes to cover reduction in available financing | Focus on continuation of performance and growth and adjustment for non-recurring COVID-19 positive |
| <i>Operating results impacted but stable with reasonable visibility of near term operating results</i> | 10-15% reduction | Part of the consideration based on performance over 1-3 yrs. | Focus on TTM and run rate EBITDAC** and forward 12-month results under various market scenarios |
| <i>Severely impacted operating results with no clear visibility to future performance</i> | 15-25% reduction (distressed sale may have higher reduction) | Part of the consideration based on performance over 1-3 yrs. | Focus on TTM and run rate EBITDAC** and forward 12-month results under various market scenarios |

* While the M&A market has been more active in July, there is not adequate data to complete a detailed market analysis. The observations in this table and article are based on Sabal team experience and recent conversations with equity firms, lenders and other investment bankers. The M&A market and COVID-19 situation are very fluid and its impact on lower middle market deal values and terms are dependent on each company's specific situation.

** Earnings before interest, taxes, depreciation, amortization and COVID-19.

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Our mantra: Always act in our client's best interest. Be transparent and keep our clients well informed. Pay attention to the details and plan ahead. Hold confidentiality in the highest regard. Think boldly to achieve optimum results.

If you are thinking of selling your business within the next 12 months, please contact us today for a confidential conversation.

**Call 561-337-5324
rmurphy@sabaladvisors.com | www.sabaladvisors.com**