COVID Shutdowns: Business Value Impacts

James Lisi

Santa Barbara Valuations

James Lisi, CVA

- Industrial Engineer and MBA
- Fortune 100, Private Equity, Small & Family Business
- Former Tech Coast Angel
- Former Finance Faculty, MBA Program, Antioch University
- Cal Coastal State Loan Committee

Disclaimer

- Valuation is forward-looking by nature
- The opinions presented are personal, not investment advice

Broad COVID Themes

- Protecting the health and safety of employees and customers comes first
- Businesses required to adapt business models, staffing and labor practices, operate at partial capacity
- Small businesses need to make all these changes at greater relative cost and with less working capital than large business

Shutdown Numbers

- Drop in Food Services employment alone is similar to past TOTAL employment declines
- Residential Construction jumped 20%
- Non-residential Construction fell 10%
- Debt is Super Super Cheap

The Pandemic Has Strengthened Some Sectors and Weakened Others

Stronger	Weaker
Life Sciences/ Digital Health	Local Services
Mobile	Hospitals
Robotics	Advertising
Process Automation	Automotive
Security	Civilian Aerospace
Defense Technology	Transportation
Food & Beverage	Leisure
Delivery Services	Retail
Hardware	High-end Fashion
Edu-tech	Hotels & Hospitality
Blockchain	Travel
Verticalized AI	Commercial Real Estate
Collaboration & Communications	Sports and Recreation
	Arts & Entertainment

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Great or Terrible?

- Terrible if you have rent, payroll and debt commitments and less revenue
- Great if you are a survivor, starting a new business or a tech firm
  - Weak companies shaken out
  - Newly Available Market goes to the survivors
  - Optimal conditions to take share and raise prices
- Online trends accelerated by two years

2019 M&A Market

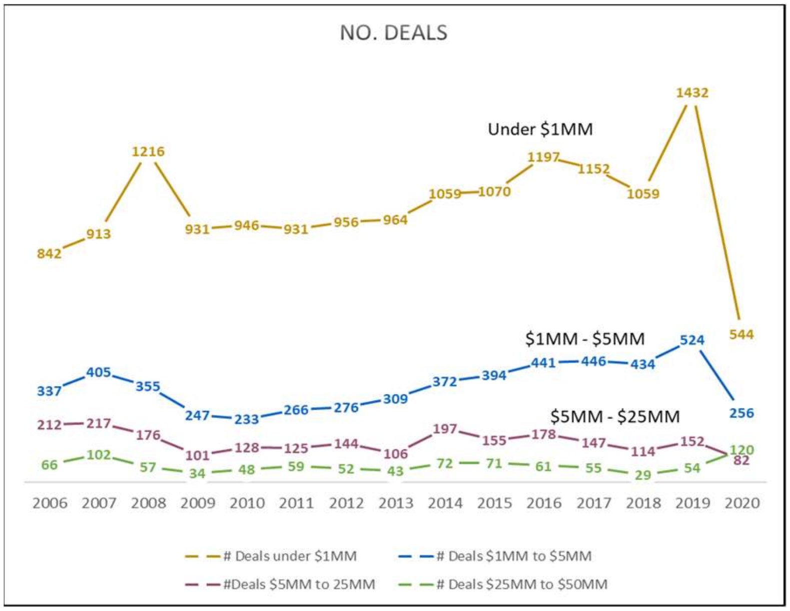
- Strong by historical standards, but softer than 2017 and 2018
- Deal value remained high because of high % of strategic deals
- Number of deals declined
- Fintech, Banking, Biotech most active
- Late cycle behavior, fully priced, Angel investors uncomfortable making additional investments
- Anticipating recession soon

2020 M&A

- Shutdowns had an almost instantaneous chilling effect on M&A activity in North America
- Annual North American deal value fell below $2 trillion for just the second time since 2015
- M&A thrived in some sectors, collapsed in others
- Speed of the M&A rebound was a surprise
- 2nd Q, # deals down 60%
- 3rd Q, # deals down 20%

2020 M&A

- Mid market buyers used less debt in their acquisitions, 44% v. 54%, because it wasn't available
- $118B of M&A in the semiconductor market may reshape that industry. Five biggest deals totaled $94B, driven by Machine Learning, AI, cloud computing, IoT and self driving cars
- Energy deal-making had the worst year in more than a decade.
- Financial services, insurance and healthcare closed out the year with significant deal activity.



Data from Deal Stats – Reported Deals, maybe 20% of all U.S. deals

Real Estate Development

- Retail – Dead. No Development. Excess capacity will be converted to other uses.
- Multi-Family – Mixed. Development pullback from high levels. Projects may be redesigned.
- Office – Collecting data. Proceeding with long term plans with near term pullback. Controlled access, HVAC systems new priorities.
- Industrial – Hot. Development increase. Online retail shifts inventory from brick and mortar stores to warehouses. More transportation hubs.

Industrial / Commercial

- Revenue Down, profit steady or up
- WFH lowered payroll and other costs
- Permanent efficiencies: cashiers, reception, sales people, travel
- 2020: 10% revenue decline
- Recovery to 2019 Revenue: 2022

Main Street

- Resellers, Repair, Personal Care, Restaurants, Bars, Landscaping
- Revenue & Profit down
- Over 50% of businesses saw revenue fall 40%
- 30% closed
- Large Corps taking share
- Chronic overwork, home school stress
- Recovery to 2019 Revenue: 2024(?)

Live Events & Travel

- Revenue down 85%
- Some events moved online
- Future value of large conferences unknown
- New base starts with 2022 annual events
- Recovery to 2019 Revenue: 2035(?)

Manufacturing

- Demand exceeding supply
- Shortages, absenteeism, sanitization limit upside
- Revenue to recover 2019 level in 2021
- Prices going up

WFH / Cloud

- Revenue up, profit up
- Location independent
- New market opportunities opened
- Growth rate doubled
- Prices going down

Four Elements of Business Value

- Cash & Inventory
- Cash Flow
- Growth
- Market Multiple

Adjust Market to Company Multiple

- Value = Company Multiple x Cash Flow + Cash & Inventory

Four Value Elements

Macro-picture….

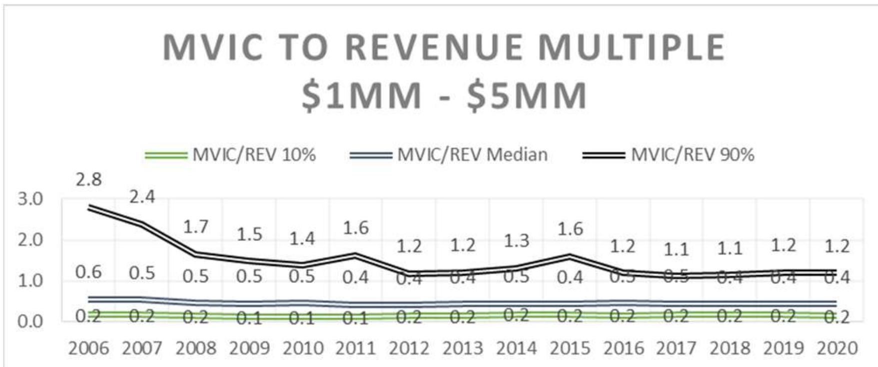
- Cash – Support by PPP and cheap money
- Cash Flow – Smaller
- Long Term Growth Expectations stable
- Market Multiple –
  - Clueless in mid 2020
  - Modest pullback from 2018-19 levels
  - Cloud multiples increased on growth acceleration
  - PE and Business Broker data showing differences
- Overall company value fell mainly because cash flow projected for 2021 was less

EBITDA Multiple – Mid Market

Enterprise Value	Historical	2019	2020
$10-$25MM	5.5x	5.7x	5.9x
$25 - $50MM	6.5x	7.1x	7.0x
$50-$100MM	7.6x	8.2x	6.8x

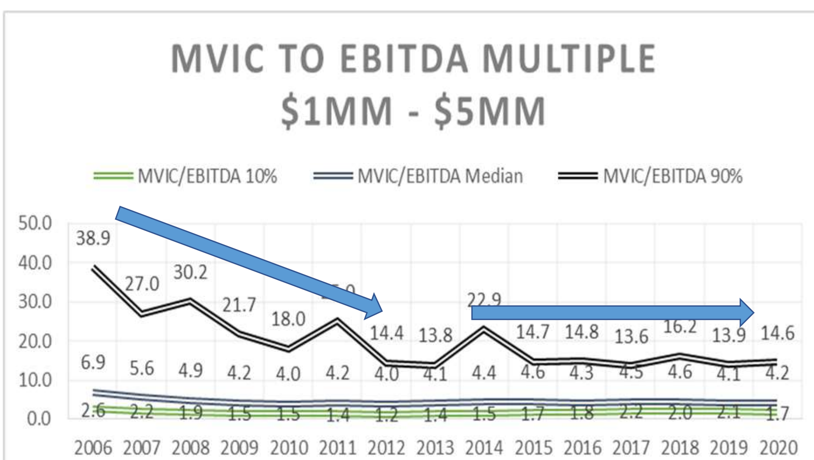
Data from GF Data (Private Equity)

Revenue Multiple, Small Biz



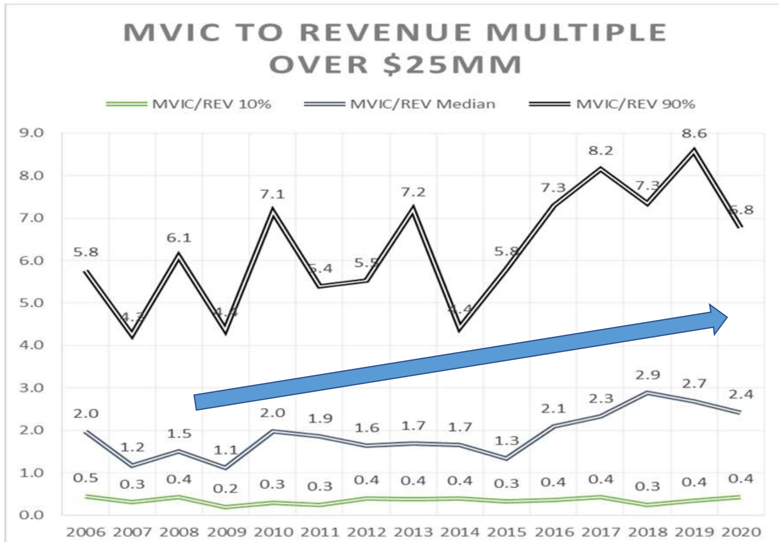
Data from Deal Stats

EBITDA Multiple, Small Biz



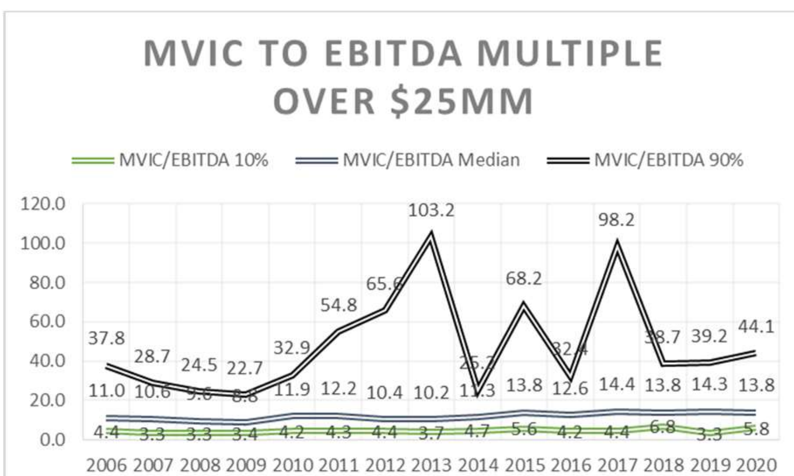
Data from Deal Stats

Revenue Multiple, Medium Biz



Data from Deal Stats

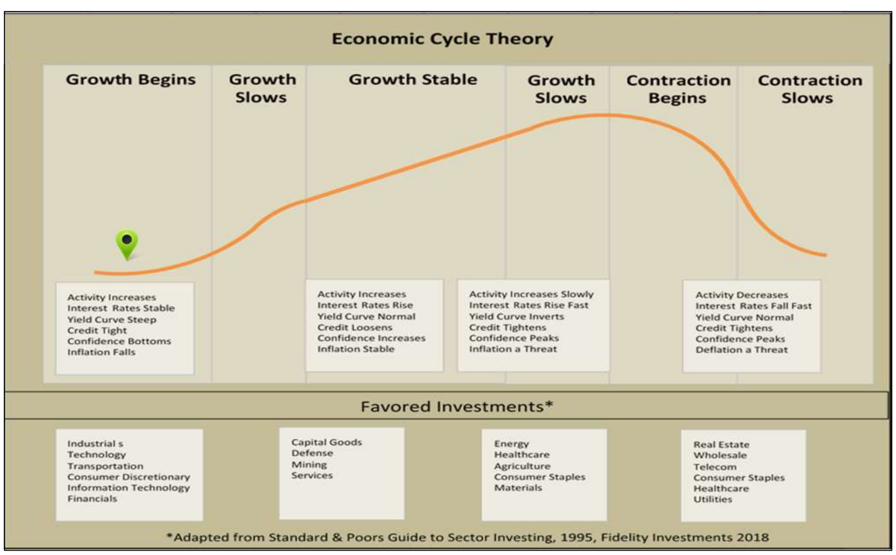
EBITDA Multiple, Medium Biz



Data from Deal Stats

2021 – A New Base

- Conditions are ideal for profit growth
- More Stimulus, almost $5T total in 12 months
- Low Interest Rates
- Fed focused on unemployment, will let inflation run hot
- Competition thinned out
- Pricing Power



What Happens to Market Multiples?

- Rise with low interest rates
- Rise with profit margin
- Rise with growth rate
- Fall with Inflation

- Market Multiple – battle of interest rates v. LT inflation
- Company value – establish new base & new growth rate

What about Debt?

- Debt is an obligation to others that has to be paid before equity holders
- Debt is best used to pull future opportunities forward
- Debt reduces the ability to pursue future opportunities

What about Debt?

- Debt reduces value to the owner when it does not help increase future cash flows
- Debt does not change value to a buyer
- Future compliance costs will act like debt in lowering business value
- Forgivable PPP debt does not affect value

Conclusions

- Company values vary significantly by situation
- For most businesses, 2021 is a base year to re-establish itself for a new growth cycle
- Business Value is a function of new base cash flow and post-shutdown growth prospects
- Market Multiples don't vary a lot over time, but inflation is a wild card
- Equity Value impacted by debt. So, net value to an owner could be substantially less than pre-shutdown if debt was added, but no new growth

Thank You

- Business Valuation
- Discounts
- Cost Segregation
- Commercial Real Estate Appraisal
- Litigation Support

James (Jim) Lisi

jim@sbvaluations.com

805-797-1710