

NAVIGATING THE COVID M&A MARKET

Maximizing value and finding certainty in uncertain times.

With three vaccines available, and a likely slowdown of new COVID cases, companies are again eyeing the M&A market. G2 has proven strategies to capture substantial value for the sellers.

in leadership. With that in mind, you need to ask yourself: Is now the right time to sell my business? How long do I need to remain connected to the business? Can I get full value for the company I built even though earnings are down due to COVID?

Companies positively impacted by COVID

While many companies and industries had to idle factories, furlough or lay off workers, rationalize product lines, etc., there were many that experienced a COVID lift as rapidly shifting behaviors and demands lead to increased revenues and market share. Examples of those that may have benefited include:

- Healthcare (remote medical services, pharmaceuticals, health and wellness)
- Outdoor leisure products (bikes, kayaks, tents, coolers)
- Home improvement and DIY materials (building products, tools, paint, flooring, patio furniture, storage bins, cleaning products)
- Packing materials (corrugated boxes) due to increased online purchasing and shipping
- Food packaging & retail
- Manufacturers and suppliers of protective equipment and sanitation products
- Shipping, trucking, and rail related services

Sellers in these markets are benefiting from increased earnings, but potential buyers want to know whether these effects will persist post-COVID. In some cases, the positive effects were the result of an acceleration of demand trends already underway – and COVID simply catalyzed the transition. Changing needs for procurement, increasing automation in manufacturing, accelerated digital transformation, and expanded cyber security capabilities for a remote or hybrid model.

It's now over a year since the start of the pandemic, and, despite a stepped-up vaccination program, and a loosening of business restrictions, a robust recovery is still a ways off. Although COVID-impacted earnings are recovering for many businesses, uncertainty remains as to what the new normal will look like, and when it will be reached.

After a slow M&A market in the spring and summer of 2020, activity has picked up through early 2021. Many have delayed M&A in the hopes of maximizing the value of the businesses they've built. Nevertheless, there are ways for sellers to achieve their goals, even in the midst of uncertainty.

Do you want to sell your business?

There are dozens of reasons to sell a business, even at a time that may seem inopportune. You may have already planned to find a buyer before COVID hit. You may want to de-risk your personal wealth when a majority of it is tied up in your business, or effectuate a smooth transition

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In other markets, COVID upended the competitive environment; weaker players couldn't respond to changing market demands and stronger, more resilient organizations won out.

The challenge for both buyers and sellers in today's market is to understand which effects are sustainable in the long-term and which are transitory.

Companies negatively affected by COVID

Of course, many industries have seen substantial contraction in revenue and downward pressure on earnings due to COVID as they grapple with supply-chain disruption, demand shifts, production constraints, personnel / health and safety factors, and retrofitting needs in the new pandemic work environment.

The companies most affected include small manufacturing, brick-and-mortar retail, travel, events, elective services and procedures, restaurants and markets, and aerospace. Traditional business practices may or may not return to pre-COVID form, but many companies are seeing a return in demand coming in tandem with the vaccine roll-out, and are now faced with supply chain ramp up issues and other challenges. Overall, the expectation is improving, with the hope that production will be able to meet oncoming demand. One example is OEM automotive... where production was halted entirely for several weeks, but has been strengthening from Q3 2020 onward as the supply chain and OEM production turns back on to meet consumer demand.

The valuation analysis is key

A valuation is based on the future economic benefits the buyer can expect to receive, typically future cash flows based on past performance. Post-pandemic, an accurate valuation is more important than ever. The challenge for sellers today is ensuring that their valuation reflects the true future value of the company. How can you value a company when it is difficult to predict how the company will perform over the next year or year-and-a-half?

Sellers are faced with a challenge: how to get credit for what a company is worth when its current state is not reflective of its future state.

The M&A Market in 2020 — and beyond

After a slow M&A market in spring and summer of 2020, activity has picked up through early 2021, but again with lots of uncertainty. Here's how deal-making unfolded during this first pandemic year, and the prospects for 2021:

Q2: In March, COVID started to have an impact on the M&A market. Deal volume was slow in Q2; when the pandemic put everything into shutdown, only deals that were already in the pipeline were pushed through. Summer was slow as businesses grappled with operating in uncertain times and portfolios were triaged. Lenders and equity owners assessed the health of their borrowers and / or their businesses.

Q3: Deal-making began to pick up mid-year and optimism continued through Q3. M&A started to normalize, as advisors / sellers began to get a handle on COVID's impact on earnings and reset expectations. Lenders grew increasingly conservative; lending capacity was modest as lenders focused on existing customer loans, making equity providers work to bridge the gap between buyers and sellers.

Q4: The optimism from Q3 was muted as a COVID cases rapidly increased heading into the year end holidays and a vaccine had yet to be approved. There had been hope that the country would have turned the corner and Q1 would see a strong recovery. But by mid-November, a measure of pessimism set in.

2021: Demand is recovering in numerous industries such as automotive, semiconductor, and oil & gas, while other industries such as building products and consumer staples remain healthy — backlogs are building and supply chains are turning back on — other areas remain challenged.

A successful valuation:

- Identifies key trends across all channels
- Illustrates performance with key customers
- Develops the add-back story and triangulates it with multiple data points / analyses
- Provides YoY / MoM analyses to show performance in 2020 and 2021 vs. prior years
- Assesses customer churn and client acquisition, and shows how these compare to prior years
- Reviews pipeline wins, and how those compare to prior years
- Assesses supply security and diversification, as well as potential adjustments based on COVID disruption
- Reviews average spend and estimates an adjustment (up or down) if average spend returns to previous levels
- Develops market share analyses and indicates if company is likely to capture additional share as competitors leave the field
- Details any other future upside

How to navigate the M&A market now

After spending much of last year in triage mode, lenders are getting active again but are taking a conservative approach to new investments. Lenders, especially banks, remain focused on EBITDA performance of the last twelve months, and limit attributed value to positive COVID-related one-time adjustments. In contrast to that conservatism, lenders, especially non-bank lenders, continue to seek yield and compete – supporting a healthy resurgence of M&A.

Sellers and buyers continue to see a gap as the world returns to normalcy. Sellers want to transact, but recognize that their current performance may not represent the true value of their business. Earnings are down but they still want to get compensated – at near or full value – for the business they've built over time. Buyers, sitting on ample cash to deploy, need to acquire and have incentive to put that money to work before a full recovery is under way.

Bridging the gap

Buyers and sellers are getting creative in order to bridge the gap caused by temporarily reduced earnings and leverage levels at which lenders are willing to finance to make a deal happen.

To bridge the gap a strong story outlining a business' shift through 2020 – from suppliers, to capacity and personnel, and to customers – drives success in today's M&A market. When uncertainty remains, values are being bridged through a number of tools; earn outs (seller receives additional payments based on future performance), equity rollovers (rolling a portion of the ownership stake into the new equity capital structure), or seller notes (a series of deferred payments), structures that reduce the buyer's risk and compensate the seller when business conditions return to normal.

In 2021, with the end of the pandemic slowly coming into view, buyers and sellers are increasingly looking to be flexible, and deals are, again, getting done. More than ever, it is the role of the advisor to build the seller's story clearly, concisely, and with conviction.

How G2 Capital Advisors can help

At G2 Capital Advisors, we are a group of sector-focused professionals who work as an extension of our clients' companies, developing and executing on M&A growth strategies. We bring industry expertise, a network of relationships, and relevant thought leadership to identify opportunities and help our clients achieve success.

Connect with our Team

With over 75 mandates in the sector, G2 has one of the most active I&M industry teams in the middle market. We recognize that our clients are faced with accelerating change within their markets. We support them in adapting to the ever-changing economic landscape and in achieving their goals for today and for the future.

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About G2 Capital Advisors:

G2 is an integrated multi-product, industry-focused investment bank focused on crafting bespoke operational and financial advisory solutions for our corporate and investor clients. We work with clients across a range of situational dynamics, from struggles with a challenging downturn to development of and execution of a growth strategy. Our breadth of service capabilities is unparalleled in the lower middle market.

We encourage you to reach out to our team for more information!

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