Links' List of Multiples and Buyers

COVID-19's Impact on Private Company Valuations

Visit us at www.linkscap.com

ACQUISITIONS
DIVESTITURES
FINANCINGS

RON CHICOYNE, CFA, CF, ICD.D
MANAGING DIRECTOR, LINKS CAPITAL PARTNERS LTD.

March 2, 2020

Current North American Private Equity Purchase Multiples Q4/19

TANGIBLE ENTERPRISE VALUE/EBITDA - QUARTERLY SPLITS									
TEV ($ millions)	1Q 2018	2Q 2018	3Q 2018	4Q 2018	1Q 2019	2Q 2019	3Q 2019	4Q 2019	**Mean**
10-25	5.9	6.5	5.8	5.6	6.1	6.6	5.9	5.7	**5.7**
25-50	6.7	6.5	7.0	7.2	6.7	7.1	6.7	7.3	**6.4**
50-100	8.7	9.6	8.3	9.4	7.0	8.0	7.8	7.3	**7.2**
100-250	8.5	8.4	8.4	9.6	8.8	9.0	10.6	9.0	**8.1**
TOTAL	6.9	7.3	7.1	7.7	6.9	7.4	7.4	7.1	**6.5**

Data Source: GF Data®

When analyzing the most recent private equity multiples, it shows there has been a reversion to the mean, with the outlier being in the $25-50 million range. It is expected that deals of this size will experience declines in multiples towards the long-term historical mean, consistent with other middle-market transactions. The multiples paid in fourth quarter are based on historical EBITDA and the future earnings of the businesses, but certainly current events were not considered in these multiples.

Impact of COVID-19

Outbreaks of the COVID-19 virus are now being experienced worldwide which is likely to have a negative impact on the Canadian economy. The current COVID-19 risk is being valued in the stock market with a sharp pullback in equity prices and a decrease in bond yields. Looking back in history at other health related events, public markets usually begin to rebound shortly after the stabilization and containment of the health scare. Investors wonder if this event will affect business in the short-term or will it be relatively long-term in nature, leaving all kinds of market uncertainty?

Some companies may experience issues receiving inventory, producing and shipping goods, or even having available labour, all of which would negatively impact profitability. If the economic events are the primary reason for the material variance in the EBITDA, should the valuation of the business be lower? On the financial statements at the end of 2020 and 2021, companies' EBITDA may be adversely impacted by these events that are well beyond the control of the management team and the company.

My thoughts on virus affected EBITDA would be to normalize any related impacts on the income statement by comparing the impaired year to the previous years' operations. There is a strong case for a positive normalization to the EBITDA by explaining these events as one-time and extraordinary. Normalizing EBITDA will bring it back in line historically by discounting the impact of the virus. However, if the underlying EBITDA multiple decreases based on the virus risk, the entity value of the company will move lower.

Private company multiples may contract in the short to medium-term as the fallout of the virus may slow growth prospects and earnings. Private equity investors and strategic purchasers will digest the new information and decide if there is a fundamental change or just short-term noise to their investment thesis, adjusting their valuation metrics respectively.

The only thing analysts know for sure is that time will tell what change if any, EBITDA multiples and private company valuations will have due to the COVID-19 viral outbreak.

Links Capital specializes in the divesting and financing of businesses in the Canadian middle market.

Links Capital's philosophy is to preserve value throughout the entire transaction process. Senior partners handle all aspects of the transaction from inception to close and beyond, maximizing proceeds.

Being experts in private equity markets and corporate finance enhances value to our clients through extensive buy and sell-side experience.

COVID-19’s Impact on Private Company Valuations

Links Capital are specialists working with private equity firms, institutional investors and strategic purchasers in raising capital and divesting of businesses

Each situation has different circumstances when dealing with normalizations and must be analyzed in full detail and be supported with relevant facts.

Assume the impact from the COVID-19 outbreak ends up being short-term in nature. Company A is forced to cease operations for one month and source alternative suppliers for inputs as their supply is disrupted from their normal suppliers. Sourcing short-term alternative suppliers comes with incremental input costs to the company, decreasing gross margins.

The closure along with the time taken to source new suppliers results in production delays, pushing out the timing for their finished products. Purchase orders that were scheduled to be produced and delivered in the fiscal year 2020 are now being produced and shipped in 2021, decreasing 2020 revenue by $10.0 million.

Company A	2019	2020
Revenue	$60,000,000	$50,000,000
Cost of Goods Sold	$37,080,000	$32,500,000
Gross Margin	$22,920,000	$17,500,000
Gross Margin %	**38.2%**	**35.0%**
EBITDA	$7,500,000	$2,080,000
EBITDA Multiple	6.5	5.7
Enterprise Value	**$48,750,000**	**$11,856,000**
Normalizations:		
COVID-19 Outbreak	$0	$5,420,000
Total Normalizations	$0	$5,420,000
EBITDA	$7,500,000	$7,500,000
Normalized EBITDA	**$7,500,000**	**$7,500,000**
EBITDA Multiple	6.5	5.7
Normalized Enterprise	**$48,750,000**	**$42,750,000**

For illustration purposes, it is assumed that the company in 2020 would have generated the same revenue that it did in 2019 absent of the impact from the COVID-19 outbreak. One may be able to demonstrate that the erosion in the gross margin from 38.2% to 35.0% and a $10 million delay in orders to 2021 are the direct result of the virus, a one time and extraordinary event beyond the control of management and the company.

Links Capital

At the end of 2020, assume that the market multiple has decreased from 6.5x to 5.7x to take into account the current risks in the market. Unfortunately, we are unable to normalize market multiples as they are fluid in nature.

In the absence of any normalizations being completed in the fiscal year 2020, the closure costs, reduction in revenue and erosion of gross margin decreases the EBITDA by more than $5.4 million. This is material from a valuation standpoint especially if the impact of the virus is considered a one-time event.

If normalizations were not made, the company’s entity value using a 5.7x multiple would have decreased to $11.9 million, a $36.9 million decrease year over year as a direct result of the virus. By normalizing the impacts of the virus in 2020 the company ends up back at $7.5 million EBITDA with a $6 million year over year variance in entity value. The difference in entity value is the direct result of the change in the EBITDA multiple from 6.5x to 5.7x, a more reasonable approach.

A key point when normalizing EBITDA is that one should consider how normalizations may positively impact future financial results. Future years may require negative normalizations to offset normalization events from previous years, for example, shifting of revenues from one year to another. Without making these negative normalizations in future years, the company may end up double counting EBITDA from prior year’s normalizations overstating the valuation of the company.

Links Capital tracks the market's purchase price valuations, term and conditions which are critical to every successful transaction

Links Capital's summary of select opportunities with strategic purchasers and North American private equity funds

Private Equity Platform Investments & Buyouts

Investors Seeking Strong Stable Cash Flows with Growth Oriented Niche Industries, (>$3million EBITDA)

Oil & Gas Refinery Turnaround (>$2 million EBITDA)

Natural Gas & Electric Utility (Maintenance vs Installation, Non-Union) (>$2 million EBITDA)

Construction Service to Self-Storage Industry (>$3 million EBITDA)

Traffic Control Safety Services (>$3 million EBITDA)

Trade Facility Services (Refrigeration, HVAC, Elevator/Escalator) (>$3 million EBITDA)

Textile Supply (Hospitality, Food Service, Healthcare, Industrial) (>$ 2million EBITDA)

Financial Technology (Account Management Debt Settlement) (>$2 million EBITDA

Aerospace/Transportation Logistics ($2-$20 million EBITDA)

Machine Shops (Medical/Aerospace) ($3-$20 million EBITDA)

Current Add-on Investments Strategic & Private Equity Purchasers

Restoration/Remediation Construction Companies

Food Co-Manufacturing

Food Beverage Packaging

Infrastructure Services

Human Capital / Management Training

Medical Device Companies

Multi-Site Healthcare Services

Fluid Power Products Distribution

Distributors Heavy-Duty Truck, Trailer Product & Advanced Repair Services

Engineering and Environmental Consulting

Manufacturer/Distributor Residential Elevator Parts

Chemical and Adhesives Manufacturers

Distributors of Air Compression, Dehydration, Filtration and Purification Equipment

Domestic/International Manufacturers of Performance Fabrics, Rugs and Specialty Textiles

Healthcare Services

High Tech Contract Manufacturing Supporting EMS Industry

Subscribe at http://www.linkscap.com/news

Links Capital

Ron Chicoyne, CFA, CF, ICD.D, Managing Director
Suite 240, 30 Springborough Blvd, SW, Calgary, Alberta T3H 0N9
Phone 403-538-5109 www.linkscap.com