Andrews Myers

Valuing Your Business after PPP

2020 was not the greatest year for small and mid-market private M&A. At least if you do not count asset purchases for book value or deals out of bankruptcy. For the companies that navigated through the year, green shoots are emerging. Anecdotally, interest in acquisitions and consolidations are picking up. There remain a couple of interesting issues relating to valuation, which I am seeing in a couple of deals right now: what do you do with 2020 revenue and PPP forgiveness when you are valuing your business?

If you received at least one PPP loan under the $2MM heightened scrutiny threshold then you may be in the enviable position of having had the PPP loan forgiven already. If you had one or more PPP loans that exceeded that threshold, you probably are still waiting. In either case, where does the PPP money sit when an outside party is evaluating your business for a potential acquisition? And what happens at closing if your loan hasn't yet been forgiven?

If the PPP loan is forgiven, it's a one-time event increasing revenue. That's the sort of event that can be evaluated fairly easily. But if you also managed to navigate the pandemic semi-successfully, and were able to both demonstrate that you properly received and used the PPP loan and also that you had proceeds leftover that were used to increase equity or pay off debt, you may credibly argue that the value of your business increased and that PPP loan proceeds should not fully be removed from the valuation of your business. Even if it doesn't show up in your valuation, it might still show up in proposed earn-out structures as part of the metric used to determine future targets.

In addition, not to get too far into accounting, the suspension of limits on the use of net operating losses in the CARES Act may have allowed you to amend past tax returns, increasing tax return amounts and cash flow. This too may improve the outlook of your business in many valuation models.

On the other hand, if you're waiting on PPP loan forgiveness, which you believe is likely to come, how should that be treated? Some buyers are requiring increased cash escrows, and some sellers are carrying unusually large amounts of cash on their balance sheets that they cannot comfortably distribute before closing, all while waiting for the wheels of justice (or internal revenue) to slowly turn. This, too, creates some complications, both in valuations and in closing mechanics.

These are all new, unique issues and there are no right answers. If you're looking to sell your business, then it's possible the potential acquirer will try immediately to treat the proceeds of a forgiven PPP loan as a one-time event that should be removed from consideration. You may have good arguments in response, based on increased net income back to 2018 and/or lowered debt levels. If, on the other hand, you're on the buy side, you may face arguments that increases in net income over a trailing three-year period must be taken into consideration, which you may not like. You also have some good arguments.

The good news is that you are not alone. We are finding our way in these new, more optimistic times together. Give us a call if you're looking to enter the M&A market or if you're already there. Let's talk.

For more information please contact: Champe Fitzhugh.