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Cyprium Partners' Michael Conaton: Get Ready for EBITDAC

SMART BUSINESS **Dealmakers**

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The liquidity and general financial footing of companies were points of emphasis in the early days of the COVID-19 pandemic. For Cyprium Partners Managing Partner Michael Conaton, most of that time was spent talking with portfolio companies about their financial position.

"It was looking into and helping our management teams look at their cash flow situations, trying to enable them to assess how the shutdowns were going to affect their respective businesses," Conaton says. "And then really it was trying to figure out — and it's a spectrum — how we keep doors open on one end of the spectrum, and on the other, how do we strategically maneuver through this?"

For Cyprium's 13 portfolio companies, in which it is a noncontrol investor, it was about helping those companies assess their cost structures and, in some cases, dialing them down commensurate with the reduction in the revenue they were seeing. Cyprium also helped them with their third-party financing — bank negotiations and applying for the Paycheck Protection Program.

"It was a frenzy, I will tell you, in the early days," Conaton says.

While the expectation is that many companies' financial metrics will reflect the challenges of operating through a pandemic, how, exactly, lenders and investors will measure a company's fitness post-COVID-19 is still being considered.

Conaton spoke with Smart Business Dealmakers about where he thinks investors will look when they begin scrutinizing deals as the economy starts to recover.

Broken balance sheets

When it comes to the financial aspect of the pandemic's impact, both in the short and long term, Conaton says liquidity situations will be a significant focus for investors and lenders. They'll also be looking at balance sheets, although most likely with a forgiving but critical eye.

It's expected that companies will extend payables and deferring lease payments when they can and deferring principal payments to banks if they're able. But even if all those things are done, balance sheets will look a little broken. Debt is not going to be commensurate with a run rate or a trailing 12-month EBITDA calculation.

"I don't think there's any right or wrong way, or black or white way, to interpret any of this," Conaton says. "But at least the senior lenders are trying to figure out how to assess that baseline EBITDA. So what is your starting point?"

EBITDAC

The question, then, will likely be, what does EBITDA reflect in a situation such as this?

"There's an acronym that is being tossed around, which is EBITDA before COVID: EBITDAC. Is that what folks are going to look at? Are they going to look at some kind of adjustment? Are they going to look at some kind of pro forma? Will they look at a run rate once you're on the other side?" Conaton says. "It'll be an interesting exercise to see what that underlying EBITDA is as a starting point for a strategic discussion for M&A, and ultimately for your covenant resets, which is probably the next agenda item for a lot of our portfolio companies once they get to the other end of this."