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How Capital Sees Companies During A Disruption

By Adam Burroughs On November 5, 2021

When Greg Skoda, senior partner at Marcum LLP, is trying to buy or invest in businesses, he looks at a companies through the lens of capital. That puts whether and how the business can scale at the top of his considerations.

“So the advice that we're giving to clients, and when we're working with clients in that regard: Where are we at today?” he says. “What's the foundation look like?”

COVID stress-tested businesses over this past year. Typically investors run models to determine a business’s future fitness based on current inputs. But, Skoda says, models typically aren’t run that consider a scenario in which 50 percent of a company’s revenue disappears overnight, or the business is suddenly growing 500 percent overnight.

Still, they’re running models to figure out what these conditions do to people, physical plants, the supply chain and more.

“So, this notion of, how do we stress test the business? What are we looking for? Can we scale and what does scale mean? How do we adjust up and down on a go forward basis?”

The answer, for Skoda, comes down to whether the company has the right team and the right people. For companies looking for growth capital, it’s a matter of what changes are needed as an investor or lender is working with that team. Is there alignment when it comes to making modifications to the business so that on a go-forward basis everyone can accomplish what they want through the relationship.

“We've had the ultimate stress test,” Skoda says. “At the end of the day when we're looking at these businesses and we're trying to position a client to help grow their business and we're looking at all these things, none of these clients that we work with are any better than their customers. And so while you may think you have the greatest business in the world, if your customer base can't buy it, if they can't get it and your supplier base can't ship it, you're not in business the way that you want to be."

For companies looking to grow, he says it becomes about what can it look like, how does it scale, where does it scale, when can it scale are critically important to growth capital. So it comes down to making sure the team, the people and the processes are in place so that the company can go to the market and take advantage of the sources for growth capital, which comes down to the types of investors. That in part means knowing how they differ from a growth capital perspective because they want different things, so companies have to be ready to find the right partner.

The advice, says Alan Zang, regional president of U.S. Bank, is that it's different if you're going for a bank revolver versus a PE injection, subordinate or mezzanine debt.

"You're going to help that client position themselves a little differently because there's a different view that's going to come that's a different prism that those investors are going to look through."

When looking for bank capital, Zang says it's all about cash flow.

"At the end of the day, there are very few, if any, balance-sheet lenders left. It's much more about cash flow and either the stability or the growth trajectory are the most important things."

He says if cash flow is incredibly volatile, it's harder to provide capital. If, for instance, EBITDA from year to year is wildly up and down, that makes it tough to lend. On the other hand, if it's relatively stable or if it's growing, that's easier for a bank to lend into because there is a higher level of certainty for a senior debt lender.

"We have to have either stability or growth in EBITDA to be able to put senior debt into a situation," he says.

Michael Moran, managing partner of Walnut Ridge, says one of the advantages of the family office model is they can be really flexible in the type of capital they provide.

“It's ours, so if we need to put it in as a different part of the balance sheet, we can do that for the time that makes sense,” Moran says. “If we need to shift it around later, we can do that. We are not operating off IRRs. We are not maximizing a quick turn. And so it's provided us enormous flexibility in the way that we look at businesses and what they're going through.”

He says the fallout from the pandemic is still unsettled, and he’s concerned about a bullwhip effect — people fear shortages and over-order to compensate, which drives shortages. The counter, he says, is to get into the core of the business, look at the team and determine if they understand how their business model works in this disrupted environment.

“Talk about your vision and where it goes once this noise stops, and the noise will stop,” Moran says.

These market conditions, he says, will test a company’s partners and advisors, capital partners and even professional service partners.

“When we looked at the business models that were investing in, we tried to say, how can we take our experience as operators, our experience as investors, and be a partner to you because we're going to be thinking of things and you're going to want a lot of voices in the room,” Moran says. “You're going to have to put egos up and to the side, and you're going to have to make sure that you really understand where the market is going in this scenario so you can get the right position in place.”

Skoda, Zang and Moran, along with U.S. Acute Care Solutions Executive Chairman Dominic Bagnoli, spoke at the recent Cleveland Smart Business Dealmakers Conference about building unique capital stack structures to fuel growth. Hit play on the video above to catch the full conversation.