

Capital Expenditures and Cash Flow

Capital expenditures are company investments in long-term assets used to generate and grow revenue and profits. Common capital expenditures include facilities and improvements, machinery, office and field equipment, vehicles, and software, all necessary to facilitate a company's operations and growth. However, capital intensity of a business can affect its valuation, as we'll discuss below.

There are two major categories of capital expenditures, or "cap ex":

1. Maintenance Cap Ex

This represents the ongoing cost to maintain current operations or keep up with changing technological needs. Vehicles, computers, and machinery don't last forever, and technology can quickly become outdated. Forgoing maintenance or replacement of these items will lead to inefficiencies, service hiccups, or production downtime. Although the investment in a new roof for a manufacturing facility does not cause revenue or profits to increase, replacing a leaking roof is a necessary repair required to maintain current operations.

2. Growth Cap Ex

In contrast to maintenance cap ex, growth capital expenditures are made to increase revenues or profits. They represent additional investments above and beyond maintenance that is needed for the business to grow. How much to invest here is determined by evaluating the expected rate of return to be achieved. For example, a factory expansion to meet increased production requirements needed for a new long-term customer contract would be a growth-producing investment. Purchasing automation equipment that increases throughput at a reduced cost is another example.

When selling your business, it is important to understand how each type of cap ex can affect your company's valuation. Capital intensive companies that carry significant maintenance cap ex burdens are generally valued less than a company that is less capital intensive. Here a significant portion of cash flow is required to maintain current operations, leaving less capital available for growth investments or providing shareholder distributions.

In many cases, buyers will view maintenance cap ex as a true, and sometimes significant, cash operating cost of a business. Capital expenditures do not flow through as an expense on the income statement, and although they do result in depreciation charges, these charges are added back when calculating earnings before interest, taxes, depreciation, and amortization (EBITDA), a popular measure of cash flow used by buyers. Because of this, many buyers will deduct significant maintenance cap ex from cash flows when valuing a company based on a discounted cash flow analysis or a multiple of EBITDA basis.

Maintenance cap ex levels will vary by industry. Despite potential effects on valuation, it is imperative to maintain your long-term assets as if you would own the business forever. Having well-maintained assets will provide comfort to a potential buyer that your business is well-run and deserving of investments in future growth. Buyers are happy to invest in growth cap ex to make a business even more valuable.

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By Steve Jacobs

Could 2021 be a record year for M&A activity? It seems to be on track for it and there are many reasons. Pent-up demand has finally been unleashed following the pandemic-induced pause, revving up acquisitions and divestitures allowing long-term trends to continue. Cash on the balance sheets of S&P 500 constituents has been looking for somewhere to go since swelling to \$1.9 trillion in early 2020. A larger number of sellers are moving their exit timeframe forward to avoid anticipated tax policy changes, including a higher

capital gains tax rate, an increased corporate tax rate, the elimination of a stepped-up basis upon the transfer of inherited assets, and carried interest being taxed as ordinary income instead of as capital gains. Some family businesses are simply rethinking their plans as the pandemic has caused them to reevaluate priorities.

Q3 2021 proved to be a record quarter. Liquidity, low borrowing costs, and seller interest caused deal volume to increase sharply. As of September, the LEI (Leading Economic Index®) had improved for seven consecutive months. Improvements in the job market, rebounding valuation multiples,

and the availability of debt and equity continue to underpin a strong market and bolster consumer confidence. Total assets under management (AUM) are expected to reach \$9.1 trillion by the end of 2025, so private equity dry powder will remain high.

However, the strong M&A market faces risks. Faster than expected inflation leads to higher interest rates and lower deal activity. For many companies, labor shortages and supply chain issues continue to delay post-pandemic recovery. In addition, the variants of COVID-19 could lower economic activity and business confidence.

With that said, we are optimistic the current M&A momentum will be sustainable. Many transactions put on hold during 2020 are moving forward. The increased supply of attractive targets will continue to fuel activity. As the economic environment further improves, well-capitalized companies and financial investors will have the means and motivation to take advantage of the market.

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Deveron Corp. Acquires Agronomic Solutions

In agriculture, where access to information can have a significant impact on production and returns, there is substantial value for service providers to expand information networks by combining resources. Deveron Corp. (TSXV:FARM), a leading agriculture digital services and insights provider, understands this value and strives to achieve it. Its acquisition of Agronomic Solutions is a recent example.

Selling wasn't on the minds of Agronomic Solutions' owners, Brandy Hodges and Nick Steffens. However, when Deveron approached them with its vision for assisting farmers in increasing yields, reducing costs, and improving farm outcomes through a digital process leveraging data collected on farms across North America, Brandy and Nick recognized the valuable role Agronomic Solutions could play in this endeavor and the benefits their customers may receive as a result. Agronomic Solutions' certified crop advisors offer unbiased solutions and services to coop, retailer, seed business, grower, landowner, and farm manager clients in Iowa, Nebraska, Missouri, Minnesota, Illinois, and Kansas – across 400,000 acres annually.

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Jim Rothermich Named Accredited Land Consultant

Jim Rothermich, MAI, ARA, ALC, has earned the elite designation of Accredited Land Consultant (ALC) from the REALTORS® Land Institute. As vice president with Iowa Appraisal (a division of BCC Advisers), Jim provides real estate appraisal services specializing in land, livestock, and grain facilities. In addition, Jim tracks results for Iowa land auctions throughout the state of Iowa, publishing this data and his market commentary on his weekly blog (iowaappraisal.com/blog) and in his monthly newsletter (iowaappraisal.com/iowa-land-auction-results).



Jim Rothermich
MAI, ARA, ALC

Michelle Temeyer Earns ABV, Promoted to Senior Financial Analyst

Michelle Temeyer, CPA/ABV, recently earned the Accredited in Business Valuation (ABV) designation with the American Institute of Certified Public Accountants, furthering her expertise as a business valuation professional. A member of BCC's business valuation team, Michelle is primarily responsible for gathering, analyzing, and documenting company background, financial, comparable company, economic, and industry information. Michelle is a leader among her peers and has been promoted to Senior Financial Analyst.



Michelle Temeyer
CPA/ABV

Climbing to New Heights

Murphy Tower Service, headquartered in Carlisle, Iowa, has been at the forefront of the technology revolution since it was founded by three siblings in 2004. As a leading provider of wireless and wireline infrastructure services, Murphy Tower Service (MTS) serves clients in the Midwest from operations in Cedar Rapids, IA; Omaha, NE; the Twin Cities, MN; and Springfield, MO. The company's skilled employees provide quality service to all major cellular communication carriers, government entities, fiber utility, and broadcast companies in Iowa and surrounding states.

Looking to grow its geographic market, MTS engaged BCC Advisers to seek out companies experienced in wireless construction services with a reputation for quality and safety, two non-negotiable core values by which MTS operates. BCC researched viable strategic acquisition targets, identified potential qualified sellers, and contacted the prospects.

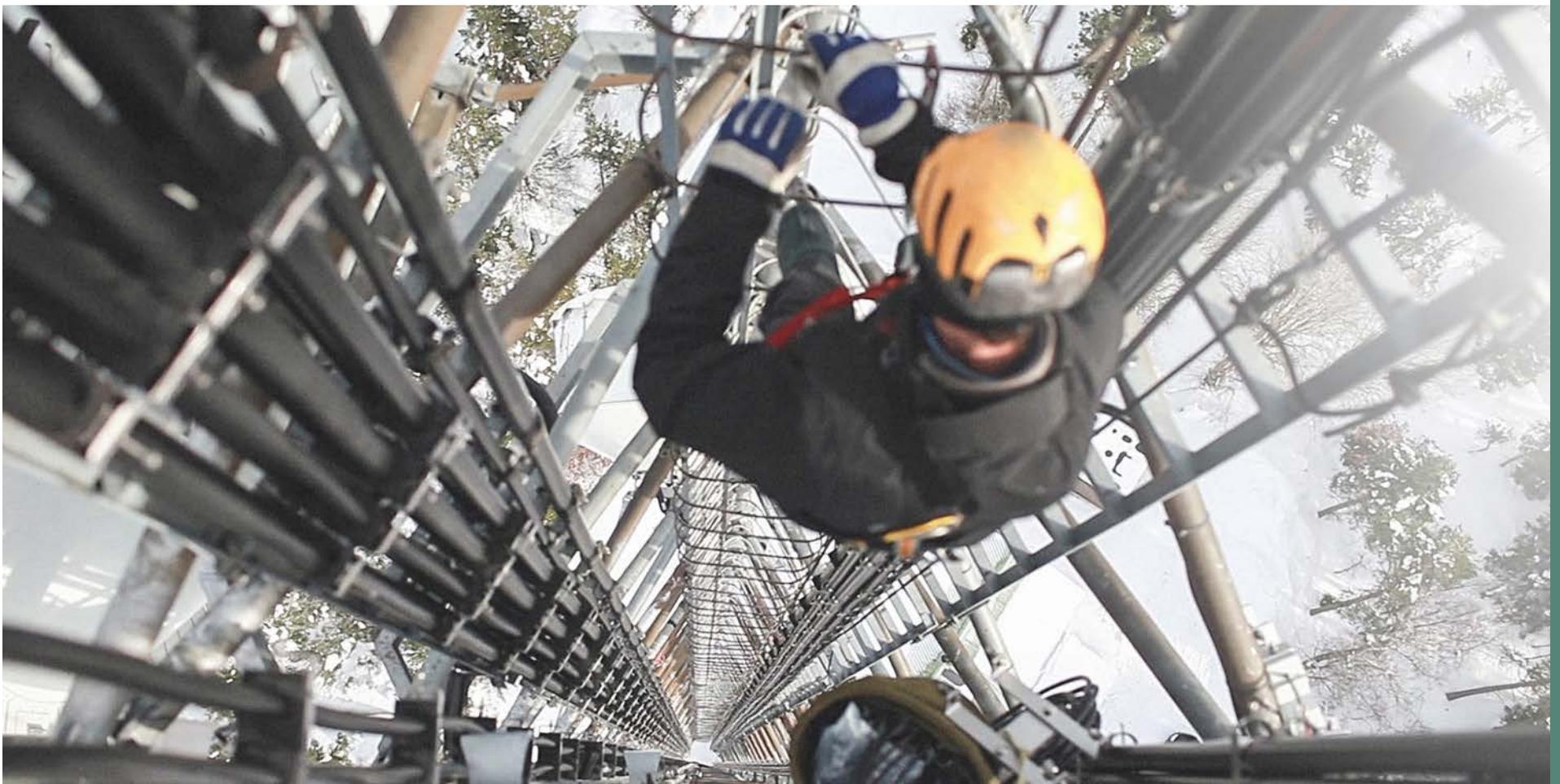
After much review, BCC identified East River Tower as an ideal candidate and approached them on behalf of MTS. With a talented team and a similar corporate culture focused on safety and quality, East River Tower ultimately joined MTS, enabling MTS to serve existing and new clients in an expanded geography. "We were not planning to sell, but after getting to know the Murphy team and seeing the opportunities they could bring to our employees and overall organization, this was an easy and natural decision for our ownership group," said East River Tower owner Joe Pejsa.

Now with over 170 employees and a service region broadened into the Dakotas and western Nebraska, MTS is well on its way to being the leading provider of wireless construction and maintenance services in the entire Midwest. "We're very excited for the East River team to join us," said Murphy Tower CEO Pat Murphy. "They bring a wide range of experience in wireless construction services and have developed a reputation for quality and safety in a geographic market in which we were actively looking to grow. BCC was instrumental in identifying the potential seller, making initial contact with the target, and provided comfort to the East River owners that MTS would be an attractive fit for their owners and employees."



MURPHY
TOWER SERVICE

BCC looks forward to a continued relationship with MTS, as it is interested in pursuing additional strategic acquisitions, particularly in the tower construction and engineering sectors. MTS's suite of services includes new cellular tower construction and maintenance, small cell installation and maintenance, in-building Distributed Antenna Systems (DAS), broadband and fiber installation, horizontal directional drilling, and commercial electric services..

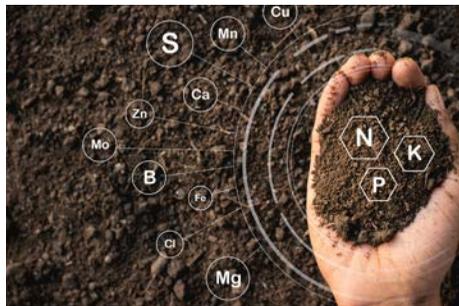


Deveron Corp. Acquires Agronomic Solutions, cont.

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Despite the natural strategic fit with Deveron, Brandy and Nick had no experience with selling a business or the M&A process and knew they needed help. Since BCC Advisers had completed business valuation work for Agronomic Solutions as part of an internal ownership succession, these two partners once again relied on BCC's advisory services, engaging the expertise of BCC's M&A team. "From evaluating whether now was the right time to consider selling, to negotiating the terms of the transaction with Deveron, to guiding us through the due diligence process and across the finish line, we fully depended on BCC to advise and represent us during this important stage for our company," stated Nick Steffens.

"Agronomic Solutions is a remarkable leader in soil sampling and soil data analytics in their operating territories. The trust that Brandy and Nick have built with their customer base is very impressive and something we look to build upon as they grow within the company," said David MacMillan, Deveron's President and CEO. "Adding Agronomic Solutions to Deveron's growing footprint is an integral step towards our vision of being North America's leader in soil health data and insights. We look forward to working with Brandy, Nick and the rest of the Agronomic Solutions team to leverage Deveron's end-to-end soil health solutions to increase their influence across Mid-Western United States."



Deveron employs a team of agronomists and data scientists that build products to recommend ways to better manage fertilizer, seed, fungicide, and other farm inputs. Additionally, they have a national network of data technicians deployed to collect various types of farm data, from soil samples to arial views via drone. Deveron's geographic focus is the U.S. and Canada where one billion acres are actively farmed annually.

Brandy Hodges, an original founder of Agronomic Solutions, commented, "Nick and I are so excited to have Agronomic Solutions join the Deveron family. Deveron's end-to-end soil health solutions and turn-key insights offer agribusinesses the opportunity to drive value through increasing yields while reducing cost. We are grateful for BCC's guidance in making this happen."

Brandy, Nick and the rest of the Agronomic Solutions team will continue in their current roles for the foreseeable future to ensure continuity of the reliable, high-level service their customers have come to expect.

on the dotted line

Some Recent BCC Advisers Transactions:

Advised a provider of wireless and wireline construction and maintenance services on an acquisition providing expanded geographic reach.



Advised a digital agronomy solutions provider on a sale to a leading agricultural digital services and insights provider.



Performed a fair market valuation of a cabinetry manufacturer to determine collateral value for loan financing.



Advised an excavation contractor on fair market valuation for a proposed transaction.



Advised an advertising agency on fair market value for a proposed acquisition by an ESOP.



Performed a fair market valuation of a radio broadcasting company for 401(k) plan administration.

The Market Front

Some opportunities available through BCC Advisers:

U.S.-based provider of industrial cleaning and maintenance services - is seeking acquisitions of the same.

European-based full-service transport and logistics provider - is seeking a buyer.

U.S.-based manufacturer of highly engineered electromagnetic products - is seeking acquisitions of the same.

European-based importer of timber softwoods - is seeking a buyer.

WE'D LIKE TO HEAR FROM YOU!

Is there a topic related to mergers and acquisitions you'd like to learn more about?
Send your request to us at info@bccadvisers.com
and we will do our best to address your question in a future issue!