

Capstone project summary

EXIT preparation and valuation of a Hungarian SME

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Project sponsor: Balazs Antal

Introduction

This report is the summary of the capstone project, based on the exit preparation process of Hungarian SME company. The sponsor of the project is Balazs Antal, teaching assistant, CEU alumni, who currently works in the private equity sector. Besides Balazs and me, our capstone M&A advisory team included my fellow classmate from the Central European University, Gergo Peszlen as well. This report contains three main parts. First, I would like to describe our work in this project, as well as the outcome of our 5 months spent together. In this part I will talk about key issues and result we identified, while presenting the result of our work as a professional consultant team. After that, I will summarize the theoretical and professional background of our M&A project, bringing a fresher and broader aspects to our case. This part is based on the comparative analyzes of scientific sources relating to our topic and four interviews, which I have conducted with industry professionals, partners and chief executives leading Hungarian M&A firms. In the third part I will compare these results with our work and with the interviews, and I try to draw a conclusion regarding the prospects of the company and the exit process as well as the value and the potential risks of the company.

The M&A project

Compared to other projects our capstone project started quite early, which I personally preferred. At the beginning, I was excited by the fact that we were not just working on one phase of the transaction, but the whole exit process. On the other hand, this benefit turned out to be also a disadvantage because of the mismatch in the educational agenda of the university.

Balazs as the supervisor of the project taught us first the main tools and goals of the profession of M&A since the only subject dealing with this topic was held in the Vienna-week, which had taken place two months after the start of our capstone project. Balazs was nice and professional though, as the teaching assistant of that subject he was able to provide us valuable preliminary information about the key points of our tasks and the workflow of the process.

Beside the quick start and the sympathy of the project and the project sponsor, I got additional personal motivation to find an M&A transaction as a capstone project. Firstly, after my experience in the field of audit, the sector of M&A looked exciting and promising regarding my professional future. My second big motivation was my family background. My grandparents have a very similar business as the investigated company, so I got very curious very quickly, about the valuation and the risk aspects of such companies. But even without the above-mentioned two factors I was very motivated about this topic since in Hungary the world of SMEs is huge and right now. In 2022, 32 years after the radical change of the market structure of Hungary, one can find large numbers of older owners, with old technologies, sub-optimal workflow, and undereducated management, which is great opportunity to capitalize on.

Our capstone project was a quite standard M&A project. The preparation process started by a consultation and a company analyzes, with the preparation of the documentation to follow, which will be sent out by the company to the potential buyers. Since there weren't any concrete partners, who we knew about, we were just doing the basic processes and tried to sum up all the issues and values based on the usual market standards. The documentation we should have done was the information memorandum (shortly info memo), a teaser of the company, and a financial model, which contains the balance sheet, the income statement, the cash flow statement, and a financial plan. Gergo was the first candidate to this group, so he picked his topic first. Gergo had a job, which was also strongly related to financials, so he had chosen the financial part of the work. I was the second candidate to this project, so I was not in the place on choosing which of the two big parts should I take but if I were in that situation, I would have chosen the info memo, too. I really like thinking about potential issues and success in bigger perspective, so finding the structural weaknesses and opportunities in the company made me more excited.

Our capstone journey started in January 2022 with a team meeting, where we introduced ourselves, our current experience and motivation about the project and the field of M&A. After that we scheduled a personal meeting at the HQ of the company, where we got an opportunity to make an interview with the founder of the company and to check the operation. This was the first act of the consultation process. We collected lots of information while being there, from

the interview and throughout the tour in the plant. After the personal meeting we switched to the electronic communication: we were able to ask questions and for documents via email. After a longer emailing period, we have organized a follow-up meeting, when we were able to discuss the current standings and the task lefts to be done. We had no information about the future buyer, only a persona, which was an international company or investor, targeting the Hungarian market. This concept simplified our task somehow but haven't made the info memo too concrete.

The Valuation

In the case of discounted cashflow method, there are three characteristics of the company, you should know for sure or at least have a highly accurate estimation on. The lifetime of the asset you buy or the cash flow, the investment will create and the discount rate, representing the riskiness and the relation to the riskiness of the company. One can easily see that all the three aspects are very difficult to estimate and using unsure assumptions to simplify the things down may be misleading. Instead of the DCF methods we can use one of the relative valuation methods. Not the usual ones like the works of Damodaran, since those relative valuation tables have their own assumptions, which are not fitting to the case we are dealing with. Nevertheless, as every market, the Hungarian SME market also has some experts using more similar assumptions to our case and can give a more accurate value. I have done four interviews with professionals from market leader M&A advisor companies. The model I used was provided by András Endrődi from Concorde MB partners. My other interviewees were Ágnes Svoób from EQUILOR, Gusztáv Láving from Hiventures – Hungarian Development Bank and Márton Fábíán from the boutique Citadel Consulting. I asked about their SME experience, which are covered in the main capstone document.

The EBIDTA of the company was around 120 MHUF in 2020, different methods lead to different result: *(Numbers slightly changed for NDA reasons, more details in the capstone discussion.)*

- Damodaran EU industrial EV/EBITDA around 7,5, which means 900 MHUF EV.
- Concorde SME standard EV/EBITDA is 5, which has a 600 MHUF EV result.
- Concorde SME corrected EV/EBITDA is 3.75, which leads to a 450 MHUF EV.
- *The value of the plant used for the business: 520 MHUF (real estate valuation, 2019)*

Shortly about my experience of the project and the company: Emotional difficulties, lack of professionalism, good luck, and bad luck. In our case, the company is sitting on a valuable real estate, which is mainly misused, while not having enough room for raw materials and

finished products, running a business without corporate culture, with huge market and regulatory exposure, squeezing out as much profit as possible. On the other hand, one can see enormous potential in the business. The partners and the strong uptrend of the sales revenue are very impressive, I can imagine professional investors, either synergically or financially motivated to make an offer in the mentioned 450 to 500 million HUF range. And with a long-term rent contract the issues around the plant could be also solved.

