

# Q1 2020



# MARKET PULSE

INTERNATIONAL BUSINESS BROKERS ASSOCIATION | M&A SOURCE | FIRST QUARTER 2020 SURVEY





A full copy of the Market Pulse survey results is available to IBBA and M&A Source members who participate in each quarterly survey. This is a 100-plus page document of up-to-date, relevant information on the state of the marketplace and compiled by Dr. Craig Everett, assistant professor of finance and director, Pepperdine Private Capital Markets Project.

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# The IBBA and M&A Source Market Pulse

## SURVEY REPORT Q1 2020

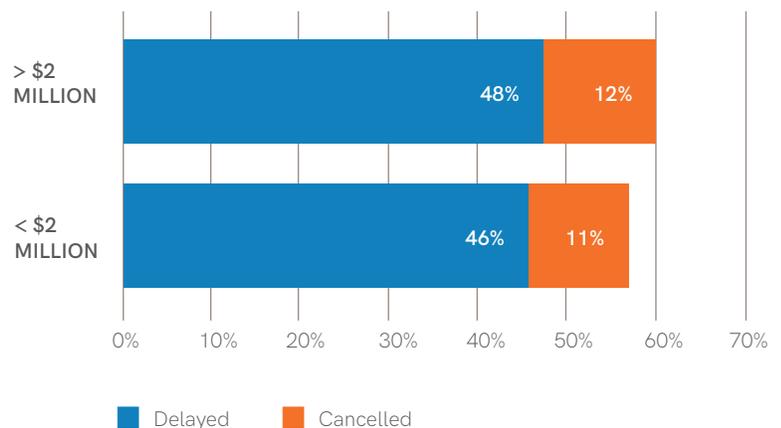
The quarterly IBBA and M&A Source Market Pulse Survey was created to gain an accurate understanding of the market conditions for businesses being sold in Main Street (values \$0-\$2MM) and the lower middle market (values \$2MM-\$50MM). The national survey was conducted with the intent of providing a valuable resource to business owners and their advisors. The IBBA and M&A Source present the Market Pulse Survey with the support of the Pepperdine Private Capital Markets Project and the Pepperdine Graziado Business School.

The Q1 2020 survey was conducted April 1-15, 2020 and was completed by 416 business brokers and M&A advisors. Respondents completed 296 transactions this quarter. This is the 31st edition of this quarterly report.

## Small Business M&A Reports Early Impact of COVID-19

While many small business owners are struggling to keep their doors open, others are finding they can no longer get out the door. A recent survey of business brokers and M&A advisors reveals that more than half of the small and medium businesses (SMBs) on the market are facing cancellations or delays in selling their businesses.

FIGURE 1: CANCELLATIONS AND DELAYS



Business brokers representing small businesses valued at less than \$2 million report 46% of their deals have been delayed and another 11% cancelled due to COVID-19. Approximately a third (36%) said their deals remained unaffected, while 7% said they represented a business that had increased in value due to the outbreak.

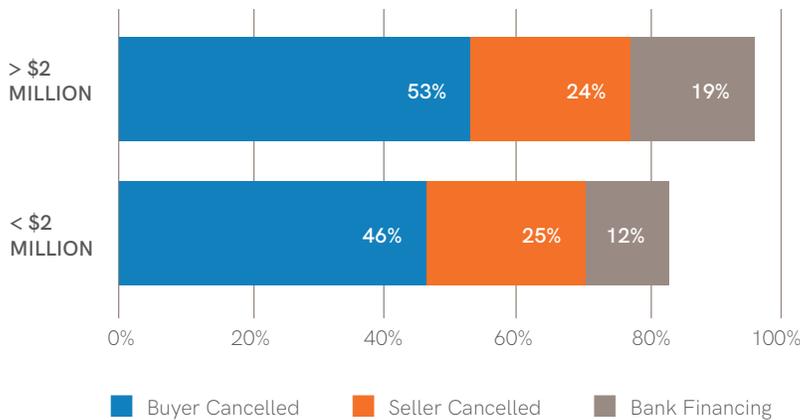
Similarly, M&A advisors representing businesses valued at \$2-\$50 million said 48% of their deals had been delayed and another 12% cancelled. Only 4% indicated that a business engagement had increased in value.

**48%**  
deals delayed  
for businesses valued at  
> \$2 million

# Buyers and Sellers Both Hitting the Brakes

Buyers were the cause of most deal cancellations. However, a quarter of cancellations came from sellers taking their business off the market. Changes in bank financing arrangements also caused some deals to fall through.

FIGURE 2: REASON FOR CANCELLATION



“As we all have seen this pandemic has forced many business owners to reinvent how they approach their day to day operations focusing on the safety of their teams, customers and families,” said Robert McCormack, managing partner, Murphy McCormack Capital Advisors.

“Likewise, many business owners are all analyzing their succession options. Like prior to the 2008 recession many business owners were trying to market time the sale to hit it at their peak valuations,” said McCormack. “This is a challenge for public traded stocks and even harder with privately held companies.”



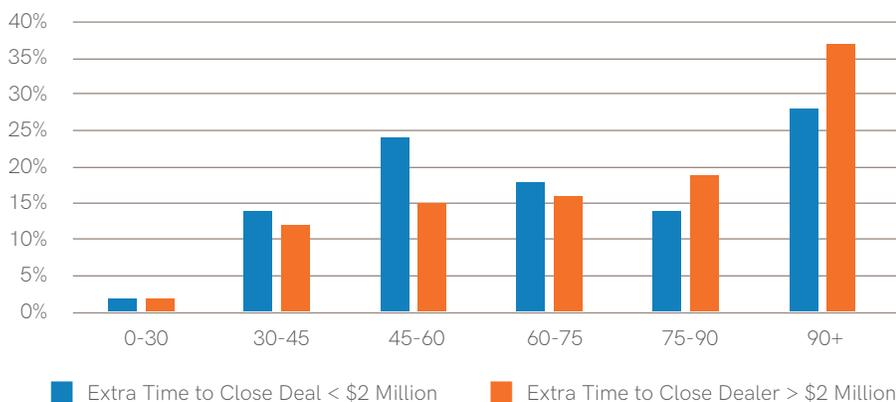
“Deal activity is always expected to constrict during times of uncertainty. Both sellers and buyers are being conservative right now, taking a wait-and-see approach,” said Scott Bushkie, managing partner, Cornerstone Business Services. “Once we have some clarity on when businesses will be allowed to reopen and in what capacity, some deals will continue to move forward.”

“For many business owners who had already put their businesses on the market, this is a temporary pause,” Bushkie continued. “Owners who were burned out or near retirement will still be looking to exit their business. The nature of that exit will look different now, but once you get so close to the finish line, it can be difficult to envision holding out for much longer.”

## Three-Month Delays

Advisors were most likely to predict that delays would take 90 days or longer. Nearly a quarter (24%) of small business brokers said they expected that delayed deals would close in another 45-60 days, but 28% said they think delays will run 90 days or longer. Advisors representing the lower middle market were even more likely to anticipate delays of three months or greater.

FIGURE 3: PERCENT OF ADVISORS ESTIMATING LENGTH OF DELAYS



Advice that business brokers who participated in the survey were giving to business owners and their referral partners at the beginning of April included:

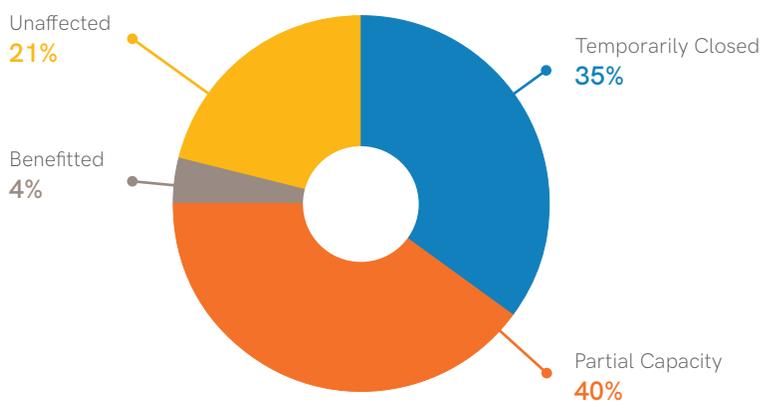
"January and February were business as usual, but when COVID-19 hit, everything came to a halt. At least a dozen states have stay at home order in place until May, and some of those will go longer. It's possible we won't see deal activity return until the third quarter."

"My advice to business owners is to use the downtime to improve your businesses. Talk to your M&A advisors about what buyers value in a business, so you can focus your efforts on improvements that will provide the most value in a sale."

## Most Businesses Partly Open

Overall, business brokers and M&A advisors report that many (40%) of the businesses they represent are operating at partial capacity, while 35% have temporarily closed, 4% have benefited, and 21% remain unaffected.

FIGURE 4: COVID-19 IMPACT ON BUSINESSES FOR SALE



# 81%

expect declines  
in business  
valuations

## Valuations Expected To Decline

Overwhelmingly, advisors expect the pandemic will have a negative effect on business valuations with 81% expecting declines and only 18% predicting a neutral impact.

Advisors also predict that the number of sellers going to market will decrease in the next quarter. On a five-point scale in which 1 = greatly decrease and 5 = greatly increase, average expectations ranged from at 2.3 for deals over \$5 million to 2.6 for deals valued at less than \$500,000. (By comparison, Q1 expectations for new engagements have never hit below the 3.3 mark in seven years of survey history.)

“When the economy is strong business owners tend to hold off on selling hoping for even stronger valuations. The pandemic, however, will push many of those sellers into the market as they try to exit before an extended recession,” said David Ryan, advisor, Upton Financial Group.

“Even if the economy manages to rebound in a short time, memories of the pandemic will stick with us. It will become part of a business owner’s psyche,” Ryan continued. “It’s possible we’ll see business owners taking a more proactive approach to exit planning and selling, well into the future.”

“There are still plenty of good businesses that are doing well right now. The multiples on those businesses should remain steady,” said Adam Petricoff, managing partner, VR Mergers & Acquisitions. “And many of those businesses that are struggling right now will be strong again, once social distancing mandates are lifted.”

“Valuations will still be based on cash flow and EBITDA, so prices will go down due to the pandemic’s impact on revenues,” said Ronald Johnson, owner, Business Sales & Valuations. “However, we’ll need to consider where we’ll see residual impact, to sales or labor models perhaps, and which are one-time anomalies that should be added back.”



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## Market Sentiment Declines

Seller-market sentiment dipped significantly this quarter. In the \$5 million to \$50 million sector, for example, only 55% of advisors described the market as a “seller’s market.” That’s a 27-percentage-point drop over Q4 2019, the largest quarter-to-quarter drop we’ve seen in the Market Pulse 31-quarter history.

Market conditions dipped only slightly for the smallest businesses valued at \$500,000 as this segment is historically a buyer’s market. However, brokers still report conditions are better than they were seven years ago in Q1 2013. *(Survey started in 2012; 2013 represents first year for which Q1 data is available.)*

FIGURE 5: QUARTER OVER QUARTER, SELLER MARKET SENTIMENT DROPS IN EVERY SECTOR

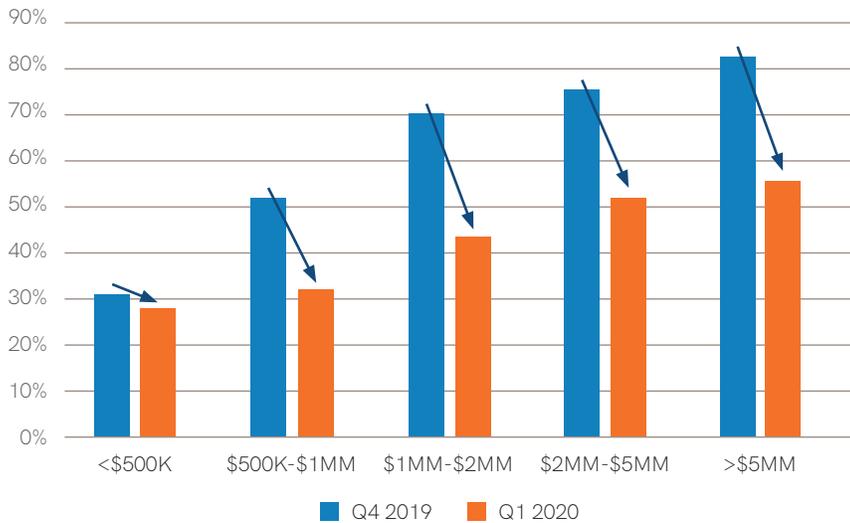


FIGURE 6: Q1 2013 TO Q1 2020, SELLER MARKET SENTIMENT



“Buyer demand was incredibly strong before the pandemic; private equity still has dry powder they need to put to use, and many strategic buyers will continue to see acquisitions as a growth strategy,” said Sally Anne Hughes, founder, Hughes Klaiber. “Over the next few weeks and months, some buyers will pause, or change their investment criteria. But other buyers will be in a position to move ahead and will continue to look for and acquire businesses that can grow or generate attractive returns.”

“In the private equity world, we’re seeing some pullback in terms of platforms deals where they don’t already have a solid grounding in a certain market space. But for industries they’re already invested in, we’re still seeing strong private equity interest because they believe in the medium-to-long-term outlook,” said David Ryan, advisor, Upton Financial Group in California.

“M&A advisors who participated in the survey indicated they’re still getting calls from new clients interested in growing through acquisition,” said John Howe, director, Business Transition Strategies. “We’ll see a temporary pause until the fog clears, but we also expect that buyers will see this as an opportunity to capitalize on an extraordinarily rare market dynamic and push forward with growth plans.”

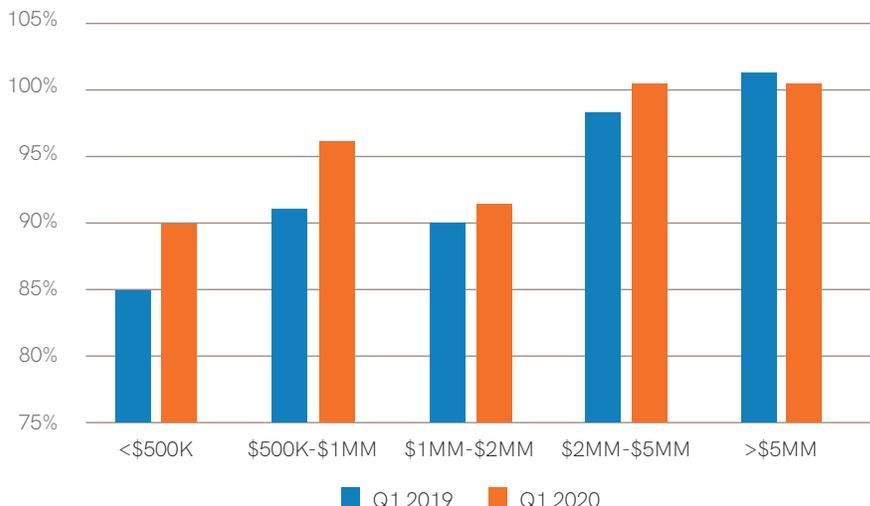
“We could see interest in Main Street deals coming from individual buyers who lost their jobs during the pandemic or see this as a reason to take more control over their own destiny,” said Craig Everett, PhD, director of the Pepperdine Private Capital Markets Project at the Pepperdine Graziadio Business School. “The SBA has a program designed to fuel acquisition activity right now, so we could actually see a jump in individual buyer activity as people rethink their work-life choices.”

NOTE: The remainder of this report reflects businesses sold in Q1 2020, the majority of which would have occurred in January or February, before COVID-19 social distancing mandates.

## Where Are Business Values Trending?

In Q1, final sale prices came in anywhere from 90% to 100% of the pre-set asking price or internal benchmark. Lower middle market companies in the \$5 million to \$50 million range achieved the highest values at 100% of benchmark.

FIGURE 7: FINAL PRICE REALIZED VS. ASKING PRICE, Q1 2019-2020



## Multiples

Multiples dipped in the lower middle market this quarter, dropping well below market peaks. Historically, multiples in Main Street have varied within about a 10% range.

FIGURE 8: MEDIAN MULTIPLE OFF PEAK

	2020 Q1	2019 Q1	2018 Q1	2017 Q1	2016 Q1	2015 Q1	2014 Q1
Median Multiple Paid (SDE)							
<\$500K	2.0	2.0	2.0	2.3	2.0	2.0	2.0
\$500K - \$1MM	2.6	2.5	2.8	2.8	2.8	2.7	2.6
\$1MM - \$2MM	3.0	3.0	3.3	3.3	3.0	3.3	3.1
Median Multiple Paid (EBITDA)							
\$2MM - \$5MM	3.3	4.3	4.4	5.3	4.0	4.5	4.3
\$5MM - \$50MM	4.3	6.0	6.1	5.3	5.5	4.9	4.5

“It appears that buyers going into Q1 2020 were already starting to build an upcoming recession into their valuation models,” said Kyle Griffith, managing partner, The NYBB Group. “Buyers saw headwinds and lowered their multiples knowing this five-year M&A run we’ve had wouldn’t last forever.”

# Cash at Close

Year-over-year trends for cash at close and seller financing are relatively consistent. Earnouts accounted for 2% or less of deal financing.

FIGURE 9: SELLER FINANCING CONSISTENT WITH 2019

	Q1 2020			Q1 2019		
	Cash at Close*	Seller Financing	Earn Out	Cash at Close*	Seller Financing	Earn Out
<\$500K	86%	12%	1%	86%	10%	1%
\$500K-\$1MM	80%	13%	2%	85%	13%	2%
\$1-\$2MM	77%	13%	2%	81%	17%	2%
\$2-\$5MM	78%	17%	1%	88%	8%	5%
\$5-\$50MM	84%	8%	2%	83%	6%	1%

\* Cash at close reflects a combination of buyer's equity and senior debt.

"We will likely see increased use of earnouts to bridge valuation gaps in the months ahead," said Barry Berkowitz, principal, Berkowitz Acquisitions. "Buyers will ask for earnouts as a way to reduce risk. If business recovers after the pandemic, earnouts are a way both buyers and sellers win."

"Our assumption is that Q2 stats will reflect less cash at close for lower middle market companies and more in earnouts or other alternative financing," said Lisa Riley, principal, Delta Business Advisors. "For Main Street deals that use SBA funding, earnouts are not an option. So, we'll probably see larger seller notes or contingencies there."



"Additionally, we might see more Main Street deals getting done over the summer, as there's an SBA program out there right now that will make your first six months of payments for you if you purchase a company by September 27," Riley continued. "That is six months of payments, not six months of deferrals, and that could sway some buyers who were on the fence about an acquisition."

# Why Are Owners Selling?

Retirement led as the number one reason to sell across all sectors, followed by burnout and new opportunities.

FIGURE 10: TOP 2 REASONS SELLERS WENT TO MARKET

<\$500K	Retirement <b>37%</b>	Burnout <b>17%</b>
\$500K-\$1MM	Retirement <b>54%</b>	New Opportunity <b>13%</b>
\$1MM-\$2MM	Retirement <b>63%</b>	New Opportunity <b>13%</b>
\$2MM-\$5MM	Retirement <b>66%</b>	Burnout <b>14%</b>
\$5MM-\$50MM	Retirement <b>73%</b>	Other <b>27%</b>

## Know Your Buyer

### <\$500,000: Buyers in this sector tend to be:

- + First time buyers (51%), serial entrepreneurs (25%), or existing companies (22%)
- + Motivated to buy a job (52%), gain a horizontal add-on (25%)
- + Located within 20 miles (70%) or more than 100 miles (15%) of the seller's location

### <\$500K-\$1MM: Buyers in this sector tend to be:

- + First time buyers (48%), existing companies (28%), serial entrepreneurs (22%)
- + Motivated to buy a job (44%) gain a horizontal add-on (31%)
- + Located within 20 miles (41%) or within 50 miles (30%) of the seller's location

### \$1MM-\$2MM: Buyers in this sector tend to be:

- + First time buyers (40%) or serial entrepreneur (33%)
- + Motivated to buy a job (43%) or get a better ROI than other investments (27%)
- + Located within 20 miles (57%) or more than 100 miles (23%) of the seller's location

### \$2MM-\$5MM: Buyers in this sector tend to be:

- + First time buyers (37%) or existing companies (37%)
- + Motivated to gain a horizontal add-on (37%) or buy a job (23%)
- + Nearly equally located more than 100 miles (31%) or within 20 miles (29%) of the seller's

### \$5MM-\$50MM: Buyers in this sector tend to be:

- + Existing companies (40%), PE firms seeking an add-on acquisition (33%), or serial entrepreneurs (20%)
- + Motivated to acquire a horizontal acquisition (67%)
- + Located more than 100 miles (80%) of the seller's location

# 52%

Motivated to buy a job in the <\$500,000 sector

# 48%

First time buyers in the <\$500K-\$1MM sector

# 33%

Serial entrepreneurs in the \$1MM - \$2MM sector

# 67%

Motivated to acquire a horizontal acquisition in the \$5MM - \$50MM sector

# What Are They Buying?

In the Main Street market, restaurants led the smallest transitions while personal services were trending throughout the sector. In the Lower Middle Market, healthcare, manufacturing, and wholesale distribution are dominating industry transitions.

FIGURE 11: TOP INDUSTRIES BY MARKET SECTOR



#### ABOUT PEPPERDINE UNIVERSITY GRAZIADIO BUSINESS SCHOOL

For the last 50 years, the [Pepperdine Graziadio Business School](#) has challenged individuals to think boldly and drive meaningful change within their industries and communities. Dedicated to developing Best for the World Leaders, the Graziadio School offers a comprehensive range of [MBA, MS, executive, and doctoral degree programs](#) grounded in integrity, innovation, and entrepreneurship. The Graziadio School advances experiential learning through small classes with distinguished faculty that stimulate critical thinking and meaningful connection, inspiring students and working professionals to realize their greatest potential as values-centered leaders. Follow Pepperdine Graziadio on [Facebook](#), [Twitter](#), [Instagram](#), and [LinkedIn](#).

The Pepperdine Private Capital Markets Project reports on the current climate for privately held companies to access and raise capital, as well as the conditions influencing the decisions of lenders and providers serving small businesses and the lower middle market. Our ongoing research engages in multiple survey research initiatives and publishes an annual Capital Markets Report, an annual economic forecast, the PCA Index Quarterly Report in partnership with Dun & Bradstreet and the Market Pulse Quarterly Report in cooperation with the International Business Brokers Association and M&A Source.

#### ABOUT INTERNATIONAL BUSINESS BROKERS ASSOCIATION

Founded in 1983, IBBA is the largest non-profit association specifically formed to meet the needs of people and firms engaged in various aspects of business brokerage, and mergers and acquisitions. The IBBA is a trade association of business brokers providing education, conferences, professional designations and networking opportunities. For more information about IBBA, visit the website at [www.ibba.org](http://www.ibba.org) or follow the IBBA on [Facebook](#), [Twitter](#), and [LinkedIn](#).

#### ABOUT THE M&A SOURCE

Founded in 1991, the M&A Source promotes professional development of merger and acquisition professionals so that they may better serve their clients' needs, and maximize public awareness of professional intermediary services available for middle market merger and acquisition transactions. For more information about the M&A Source visit [www.masource.org](http://www.masource.org) or follow The M&A Source on [Facebook](#), [LinkedIn](#), or [Twitter](#).

