

Q2 2020

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MARKETPULSE

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

With Compliments





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.

To become a member, please contact the IBBA and M&A Source.

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The IBBA and M&A Source Market Pulse

SURVEY REPORT Q2 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.

The Q2 2020 survey was conducted July 1-15, 2020 and was completed by 361 business brokers and M&A advisors. Respondents completed 176 transactions this quarter. This is the 32nd edition of this quarterly report.

FIGURE 1: MARKET SEGMENTS STUDIED

MAIN STREET	LOWER MIDDLE MARKET
Less than \$500K	\$2MM - \$5MM
\$500K - \$1MM	\$5MM - \$50MM
\$1MM - \$2MM	

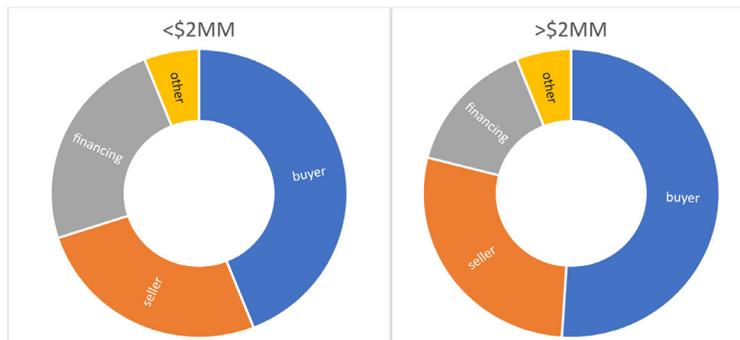
37%

deals delayed by buyer for businesses valued at > \$2 million

Small Business M&A Shaken, but Resilient

The M&A market continues to be somewhat resilient, although sellers face hurdles and delays in Q2 2020.

FIGURE 2: REASON FOR DELAYS



In surveying Main Street business brokers (representing businesses valued under \$2 million), we found that 36% of their deals had been delayed, 16% had been cancelled, and 40% remained unaffected. (Of note: business brokers previously reported 11% of their deals cancelled in Q1 2020.)

Of the delayed Main Street transactions, 24% were expected to be delayed up to 45 days, 21% were expected to be delayed 60 days, and 26% were facing 90+ day delays.

Delays were attributed to the buyer (44%), the seller (26%), and to bank financing issues (24%).

In surveying lower middle market advisors (representing businesses valued between \$2 million and \$50 million), we found that 37% of their deals had been delayed, 10% were cancelled, and 41% remain unaffected. (These advisors previously reported 12% of their deals cancelled in Q1 2020.)

Of the delayed transactions, 17% were expected to be delayed up to 45 days, 16% were expected to be delayed 45-90 days, and 29% were expected to be delayed 90 days or more.

Delays were attributed to the buyer (51%), the seller (28%), and to bank financing issues (15%).

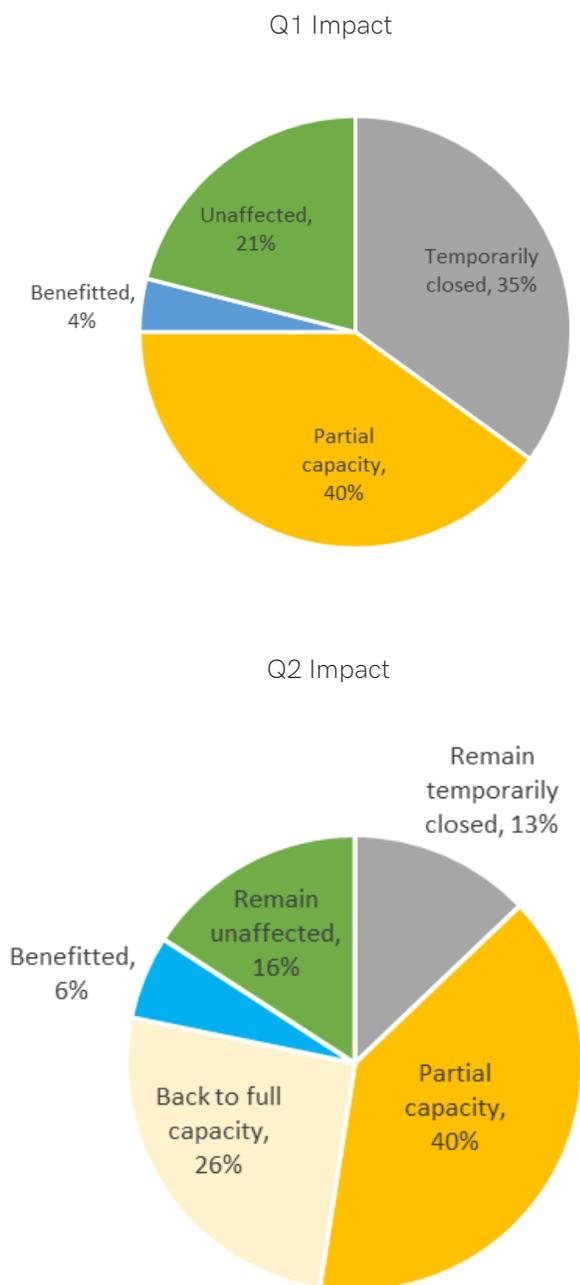
Overall, advisors from both sectors predicted the market wouldn't return to pre-March 2020 levels until Q1 or Q2 2021 (24% and 22%, respectively).

"What we've been hearing is that some lenders have chosen to focus on their existing portfolio," said Steve Mariani, owner of Diamond Financial Services. "Those that stayed in the market are taking a slightly more conservative approach, reducing the multiples they will lend against."

Nearly Half of Businesses at Full Operations

Overall, advisors reported that nearly half (48%) of their clients were operating at normal capacity in Q2. That includes 26% who had returned to normal operation after some level of reduction, 16% that remained unaffected through the pandemic, and 6% who had benefited. Another 40% are still at partial capacity while 13% remain temporarily closed.

FIGURE 3: COVID-19 IMPACT ON BUSINESSES FOR SALE



“Lenders had other priorities in Q2. They were overwhelmed by government assistance programs and were focused on triage among their existing loan portfolio,” said Barry Berkowitz, Principal, Berkowitz Acquisitions. “We believe that lenders are just now moving out of emergency response mode so they can actively pursue new business again, albeit with a more cautious eye.”

“Lenders are still busy with government loans, with new applications to the Paycheck Protection Program coming in while applications for loan forgiveness will also be headed their way soon,” said Larry Hughes, Principal of The Hughes Group & Associates, Inc. “Meanwhile, SBA lenders are busy helping buyers who want to get in before the September 27 deadline for loan relief. They’re juggling a lot.”

COVID-19 Not the Only Factor

In terms of current events, advisors were most likely to say that COVID-19 and state shutdowns were having a negative impact on the market, however advisors also rated riots, protests, and election activity as dampening forces.

FIGURE 4: PERCENT OF ADVISORS STATING CURRENT EVENTS IMPACT ON MARKET

	Extremely Negative	Moderately Negative	Minimally Negative	No Impact	Minimally Positive	Moderately Positive	Extremely Positive
COVID-19	44%	47%	8%	0%	1%	0%	0%
State Shutdowns	50%	40%	7%	2%	0%	0%	0%
Protests	14%	20%	32%	32%	1%	1%	0%
Election Activity	7%	21%	33%	37%	2%	0%	0%
Riots	19%	23%	27%	31%	1%	0%	0%

“It will be interesting to see if this is just a blip or a true trend over the next couple of quarters,” said Robert McCormack, Managing Partner, Murphy McCormack Capital Advisors. “Private equity still has a lot of cash and ticking time clocks on their portfolios. Fundamentally strong businesses will still find buyers, despite the strongest headwinds we’ve seen since the Great Recession.”

“Unfortunately, our brains have a built-in negativity bias especially when dealing with so much uncertainty. I think that’s some of what we’re seeing with seller’s market sentiment right now” said Pino Bacinello, Principal of Pacific M&A and Business Brokers. “The hurdles are not insurmountable. As we all get a little more comfortable with remote negotiations, we’ll be able to move past a lot of temporary delays.”

“There is a ‘new-normal’ in the M&A market, but we don’t have very much clarity on what the future holds. Whether or not we face future shutdowns and new spikes in infections will sway conditions moving forward,” said Bacinello continued.

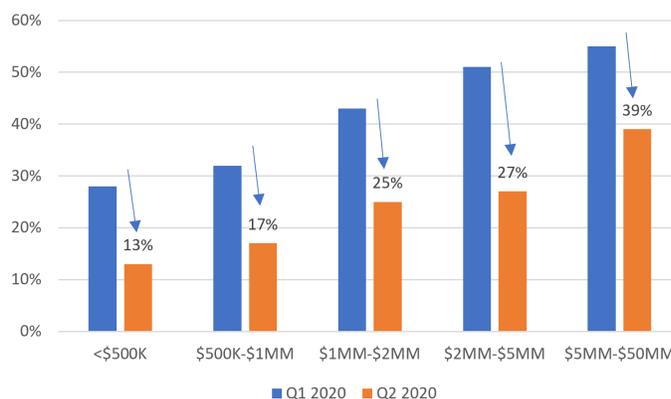
Market Sentiment Drops to Record Low

Seller-market sentiment dropped to record lows this quarter, falling well below levels seen during the last eight years. This is the first time in Market Pulse history, dating back to 2012, that seller-market sentiment dropped below 50% in the lower middle market.

Previous lows last reported in each sector:

- <\$500K: Q3 2014 at 22%
- \$500K-\$1MM: Q3 2013 at 36%; Q1 2020 at 32%
- \$1MM-\$2MM: Q1 2014 at 42%
- \$2MM-\$5MM: Q2 2014 at 51%
- \$5MM-\$50MM: Q3 2014 at 63%; Q1 2020 at 55%

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

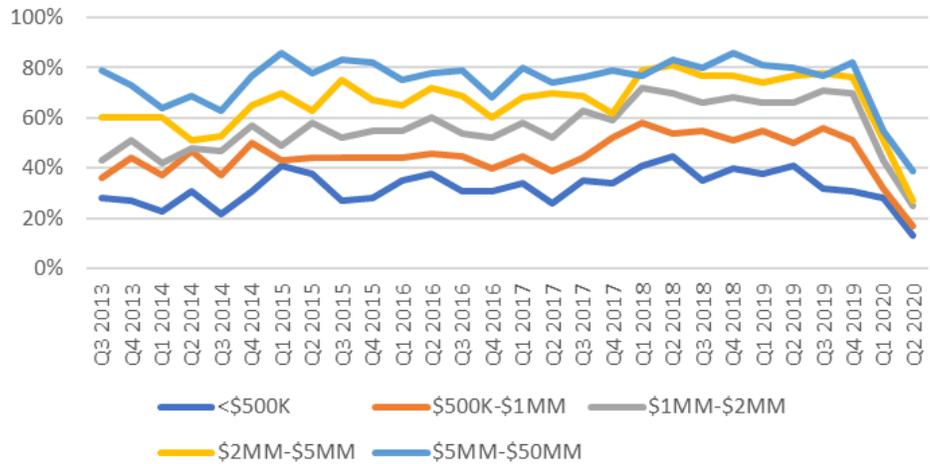


39%

decline in seller market sentiment - record low!



FIGURE 6: SELLER MARKET SENTIMENT AT RECORD LOWS

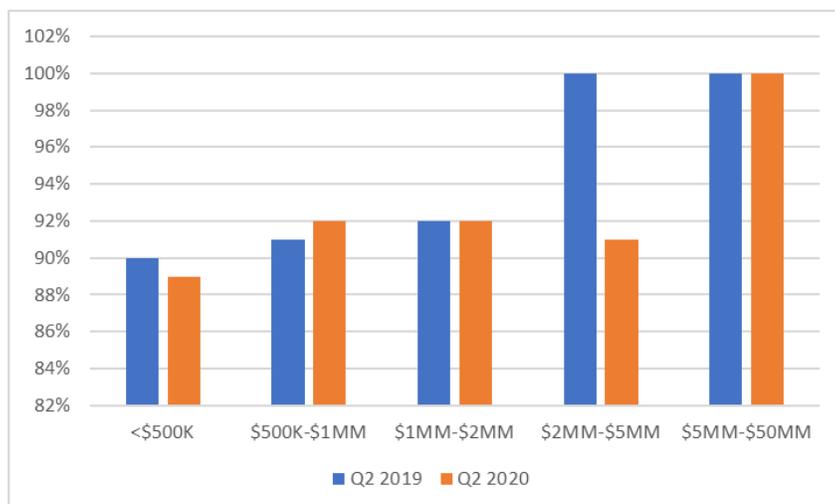


WHERE ARE BUSINESS VALUES TRENDING?

In Q2, median final selling prices came in anywhere from 89% 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.

“We’ve talked with multiple private equity firms, and they’re estimating the flow of potential new deals coming their way is down 50 to 70% over 2019. So even though some buyers have left the game, we still have a competitive environment,” said Scott Bushkie, Managing Partner, Cornerstone Business Services. “That’s why quality deals are still getting the full benchmark.”

FIGURE 7: MEDIAN PRICE REALIZED VS. ASKING PRICE, Q2 2019-2020



“These buyers are traveling less and getting fewer deals across their desk. That means strong companies might have an easier time getting attention right now,” Bushkie continued. “If you’ve been unaffected by the pandemic, now may be the time to take advantage of the market. However, if business is down and you still haven’t returned to normal operations, you might need to wait, put your head down, and grind through.”

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FIGURE 8: MEDIAN PRICE REALIZED VS. ASKING PRICE, Q2 2019-2020

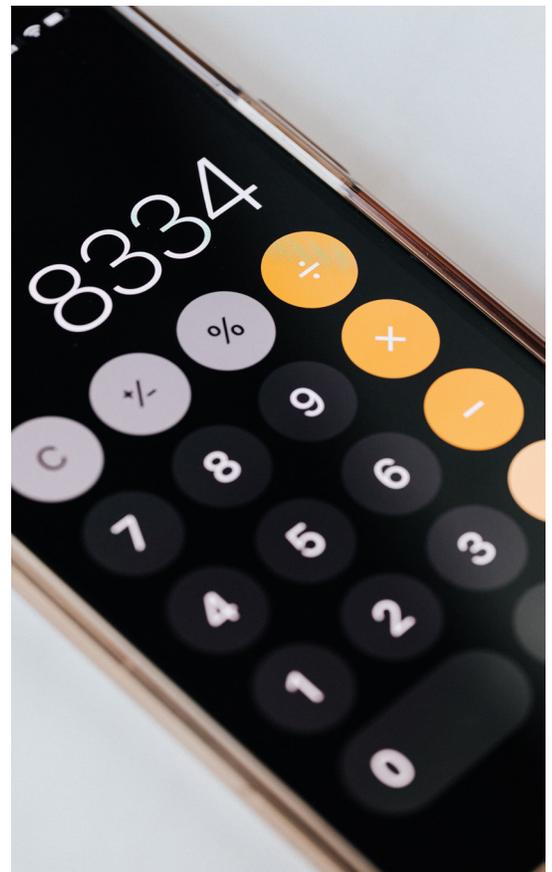


Multiples

For the first time in survey history, median multiples dipped below 2.0 for the smallest Main Street businesses. Notably, other Main Street businesses matched market peaks.

FIGURE 9: MEDIAN MULTIPLE OFF PEAK

	2020 Q2	2019 Q2	2018 Q2	2017 Q2	2016 Q2	2015 Q2	2014 Q2
Median Multiple Paid (SDE)							
<\$500K	1.8	2.0	2.0	2.0	2.3	2	2
\$500K - \$1MM	2.8	2.5	2.5	2.3	2.8	2.5	2.8
\$1MM - \$2MM	3.3	3.1	3.3	3.3	3.3	3.0	3.1
Median Multiple Paid (EBITDA)							
\$2MM - \$5MM	4.0	4.0	3.8	4.3	4.0	4.0	4.5
\$5MM - \$50MM	5.5	5.9	5.9	5.4	5.1	5.0	5.4



Cash at Close

Year-over-year trends show a slight downtick in cash at close in most sectors with corresponding increases in seller financing and/or earnouts.

FIGURE 10: EARNOUTS UP OVER 2019

	Q2 2020				Q2 2019			
	Cash at Close*	Seller Financing	Earn Out	Retained Equity	Cash at Close*	Seller Financing	Earn Out	Retained Equity
<\$500K	76%	13%	5%	1%	87%	12%	1%	-
\$500K-\$1MM	87%	12%	-	1%	84%	10%	-	-
\$1-\$2MM	85%	13%	2%	-	85%	8%	3%	1%
\$2-\$5MM	87%	10%	1%	2%	83%	8%	-	-
\$5-\$50MM	84%	4%	5%	2%	94%	4%	1%	-

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

"We expected to see an increase in earnouts due to COVID-19. With potential new shutdowns ahead and ongoing economic uncertainty, earnouts represent a way for buyers to reduce risk," said Lisa Riley, Principal, Delta Business Advisors. "Frankly, I think we expected a bigger jump in seller financing, particularly since earnouts are not an option for deals that use SBA funding."

"Buyers still hold record amounts of capital for acquisitions, but they are looking at deals somewhat differently now. They will be more likely to request earnouts and other deal structures in order to share some risk with sellers," said David Ryan, Advisor, Upton Financial Group in California. "However strong buyer competition could continue to drive strong cash at close. This will be a trend to watch."



"Main Street SBA lending should stay fairly consistent at least through the next quarter," Riley continued. "However, in the lower middle market, we may not see the same leveraged multiples we did pre-COVID-19. For example, a senior lender who might have been lending against a three-multiple of EBITDA in the past might cut that a half turn to 2.5."

Why Are Owners Selling?

Retirement led as the number one reason to sell across all sectors. In the \$5MM-\$50MM sector, 20% of sellers were triggered by an unsolicited offer - indicating an active buyer pool exists in this sector.

FIGURE 11: TOP 2 REASONS SELLERS WENT TO MARKET

<\$500K	Retirement 26%	New Opportunity 20%
\$500K-\$1MM	Retirement 50%	Relocation 17%
\$1MM-\$2MM	Retirement 63%	New Opportunity 16%
\$2MM-\$5MM	Retirement 60%	Family Issues 20%
\$5MM-\$50MM	Retirement 40%	Unsolicited Offer 20%

Know Your Buyer

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

- + First time buyers (45%), serial entrepreneurs (30%), or existing companies (20%)
- + Motivated to buy a job (47%), gain a horizontal add-on (25%)
- + Located within 20 miles (72%) or more than 100 miles (16%) of the seller's location

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

- + First time buyers (42%), existing companies (29%), serial entrepreneurs (29%)
- + 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 (42%), within 50 miles (26%), or more than 100 miles (26%) of the seller's location

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

- + First time buyers (40%) or serial entrepreneurs (27%)
- + Motivated to buy a job (27%)
- + Located within 20 miles (47%), within 50 miles (20%), or within 100 miles (20%) of the seller's location

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

- + PE firms seeking a platform acquisition (40%), PE firms seeking an add-on acquisition (27%), or existing companies (13%)
- + Motivated to acquire a horizontal acquisition (33%) or a vertical acquisition (33%)
- + Located more than 100 miles (67%) of the seller's location

72%

Located within 20 miles in the <\$500,000 sector

44%

Motivated to buy a job in the <\$500K-\$1MM sector

40%

First time buyers in the \$2MM - \$5MM sector

66%

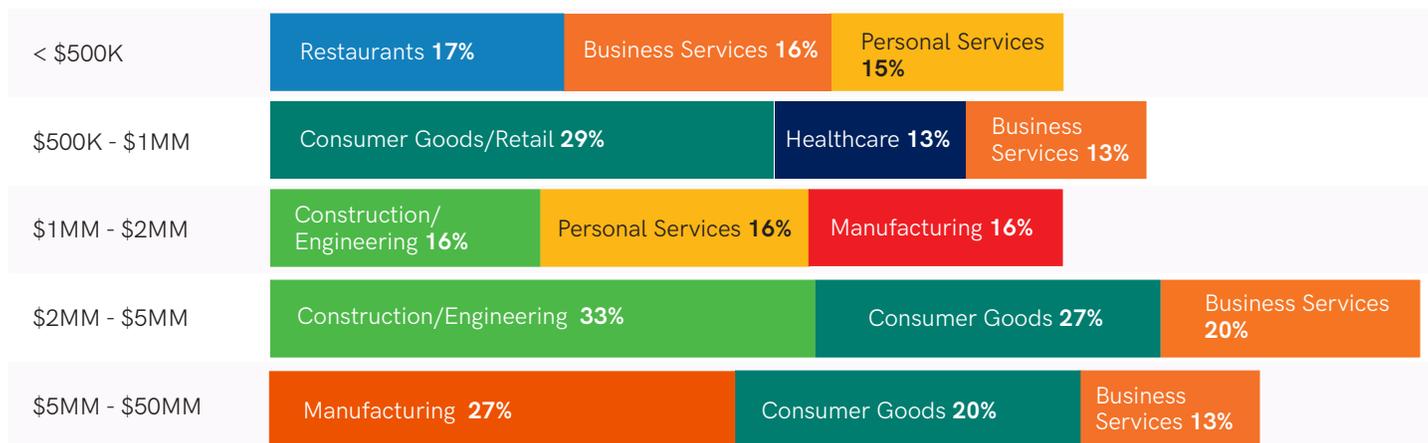
Motivated to acquire a horizontal or vertical acquisition in the \$5MM - \$50MM sector

“In the \$5 million and up sector, private equity made five-times the acquisitions over existing companies in Q2. That’s a significant presence and one we haven’t seen to such an extent in the past,” said Kyle Griffith, Managing Partner of The NYBB Group. “It will be interesting to see if they continue to dominate in the months ahead.”

What Are They Buying?

Restaurants led among the lowest priced businesses in the Main Street market, while manufacturing led among the highest value businesses. Business services and consumer goods/retail dominated industry transactions.

FIGURE 12: TOP 3 INDUSTRIES BY MARKET SECTOR



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 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 or follow The M&A Source on [Facebook](#), [LinkedIn](#), or [Twitter](#).

ABOUT DELTA BUSINESS ADVISORS

Delta Business Advisors is a boutique firm focused on assisting business owners of privately held businesses with the sale or acquisition of a business. Our brokers specialize in business sales transactions, predominantly in Arizona, however, we have experience and contacts throughout the US and the world.

Our brokers provide exceptional service with an emphasis on confidentiality and integrity. We assist both buyers and sellers to achieve their business goals. Whether you are buying your first business, planning your exit strategy or looking to grow through acquisitions, Delta Business Advisors can assist you every step of the way through our expertise, systems and connections.

BTW: It is never too early to start planning your exit, whether your plan is in 1, 3, 5 or 10+ years! The more prepared you are, the greater the amount you will keep in your pocket!

For a free and confidential consultation, please contact Delta Business Advisors at 480-686-8062 or www.DeltaBusiness-Advisors.com.

