Q3 2020

MARKETPULSE

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

IBBA INTERNATIONAL BUSINESS BROKERS ASSOCIATION.®

M&A Source®

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.

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The IBBA and M&A Source Market Pulse

SURVEY REPORT Q3 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 Q3 2020 survey was conducted October 1-15, 2020 and was completed by 352 business brokers and M&A advisors. Respondents completed 301 transactions this quarter. This is the 34th 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	

59%

deals on market relatively pandemic-proof

Pandemic-Proof Businesses in Demand

The latest data from the Market Pulse survey of business brokers and M&A advisors suggests that pandemic-resistant businesses are in demand. Advisors completed 301 transactions in Q3, a 71% increase over Q2 2020 and a 43% increase year-over-year.

Advisors report that 25% of the businesses they represent have either benefited from the pandemic or remain unaffected in Q3. Another 34% are back to operating at full capacity. Together, that means 59% of businesses on the market have distinguished themselves as relatively pandemic-proof.

"Whether a business has remained relatively unaffected through the pandemic or whether they've been able to bounce back quickly from the shutdowns we had this spring – either way, they've shown themselves to be remarkably resilient to hard times," said Barry Berkowitz, Principal, Berkowitz Acquisitions.. "Buyers are eager to get a look at those opportunities."

CARES Act incentives also drove business acquisitions in Q3. The SBA is covering six months of principle and interest on select acquisitions that were completed before September 27th.

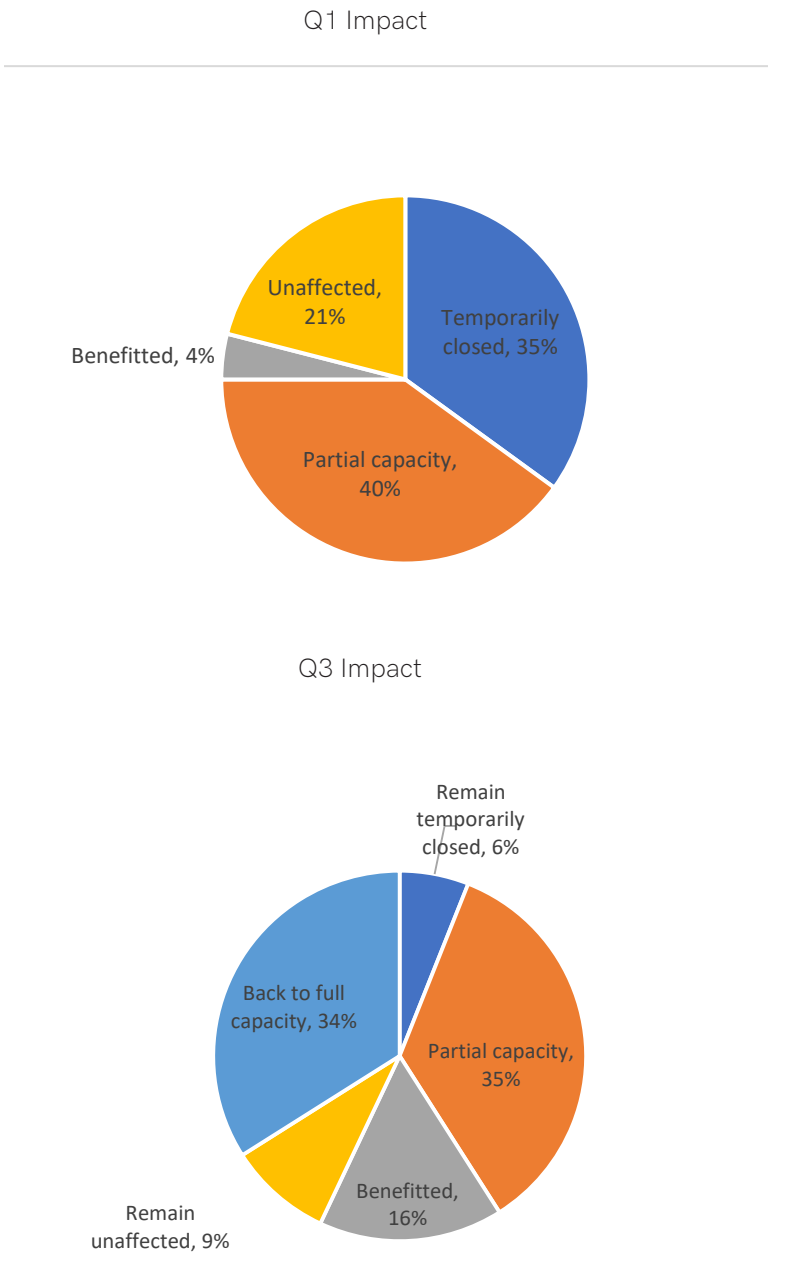
"CARES Act incentives definitely gave the Main Street market a boost" continued Berkowitz. "We were able to close a number of transactions that wouldn't have looked as attractive without that added influx of cash. Buyers that would have maybe taken a more conservative wait-and-see approach were spurred to action."

Data also suggests that many businesses may be generating a higher return than they did one year ago. Median sale prices (as a percentage of the asking price or internal benchmark) are up year-over-year in all but one sector. Meanwhile, multiples remain strong, although down slightly over Q3 2019.

One Third of Businesses Back to Full Operations

Overall, advisors reported that nearly half (48%) of their clients were operating at normal capacity in Q3. That includes 34% who had returned to normal operation after some level of reduction, 9% that remained unaffected through the pandemic, and 16% who had benefited. Another 35% are still at partial capacity while 6% remain temporarily closed.

FIGURE 2: COVID-19 IMPACT ON BUSINESSES FOR SALE



"It's true that some buyers are hoping to get a deal. But a lot of buyers are simply maintaining pre-pandemic growth plans. They have cash that they need to put to work," Kyle Griffith, Managing Partner of The NYBB Group said. "And that means we're still seeing strong interest for pandemic-resilient businesses."

"If your business has not been affected by the pandemic, or if you've been able to bounce back from an initial blow, this could be a very good time to go to market," Griffith continued. "If you've weathered the COVID test and come out okay, you are going to get attention."

Election Concerns Pale Against Pandemic

PPP repayment concerns are impacting some business transitions. A third (33%) have delayed closing due to unknown PPP status. Similarly, a third (30%) are struggling with risk allocation issues in negotiations, with debates over who will be responsible for the loan if it is not forgiven by the government. And, frustratingly, 12% have experienced bank refusals to support transactions with an outstanding PPP loan.

"PPP loans have complicated deals, no doubt," said Lisa Riley, Principal of Delta Business Advisors. "People are worried about loan forgiveness and payback periods. Others are optimistic that the government will just forgive all smaller loans. We don't know what's going to happen, so these loans have become one extra hurdle to get a deal closed."

Not surprisingly, 85% of advisors say the pandemic has had a "moderately" or "extremely" negative impact on the M&A market. What's notable here is that this is more than double the number who say the same about this year's election activity (37%).

"Election years always disrupt the M&A market. It doesn't like uncertainty," said H. Winston Hines, Broker of HWH Properties. "We're in strange times when something is more disruptive than the question of which candidate will lead our country in the years ahead. "

Advisors Divided on When We'll Return to Normal

Advisors are divided on when they think the M&A market will return to pre-pandemic conditions. Nearly a third (29%) think that the market will return to normal in Q2 2021. And yet, 20% believe that we'll be waiting until 2022 or later. One-tenth (11%) of advisors are having great success in this market and believe conditions have already recovered.

"Those of us representing larger, pandemic-proof businesses are seeing unprecedented interest from buyers right now," said Scott Bushkie, president of Cornerstone Business Services. "Buyers are still looking for good opportunities, but so many sellers are holding back and staying on the sidelines. That's driving wide imbalances in supply and demand."

"We also know that unemployment is driving some buyers to market," Bushkie continued. "Some experienced, highly qualified professionals lost their jobs in the pandemic, and those people are looking to take more control over their own destiny. Buying a small business provides control and autonomy you just can't get in the job market."

Meanwhile, advisors do expect a small uptick in sellers going to market by year end. This is a marked difference over the pessimism they showed in the 1st Quarter.

FIGURE 3: EXPECTATIONS FOR NEW CLIENT ENGAGEMENTS IN FOLLOWING QUARTER (5-POINT SCALE)

	Expected Change in New Clients Predicted in Q3	Expected Change in New Clients Predicted in Q1
<$500K	3.3	2.6
$500K - $1MM	3.3	2.5
$1MM - $2MM	3.3	2.4
$2MM - $5MM	3.3	2.4
$5MM - $50MM	3.3	2.3

"For the first 3 quarters of 2020 the M & A market has seen much uncertainty with the pandemic, an economic slowdown and an uncertain election," said Robert McCormack, Managing Partner, Murphy McCormack Capital Advisors. "However, many of our members are reporting record deal volume in many sectors of the economy."

11%

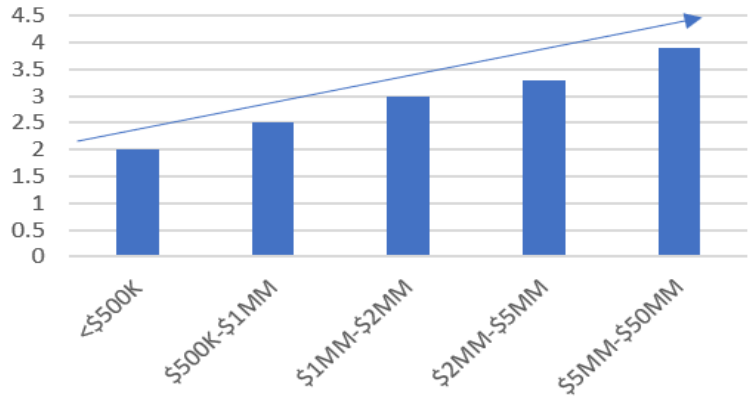
Buyers >100 miles Purchasing <$500K Business

Bigger Companies Command Bigger Values

The latest data from the Market Pulse survey reflects the growing premiums business owners receive as the size of their company increases. Multiples increase consistently as businesses get larger. And these businesses are more likely to draw buyer interest from the widest geographic radius.

FIGURE 4: MEDIAN MULTIPLES INCREASE WITH BUSINESS SIZE

SDE



EBITDA

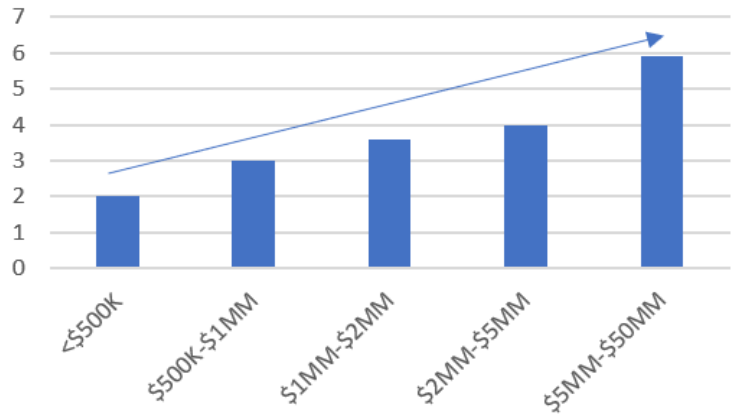
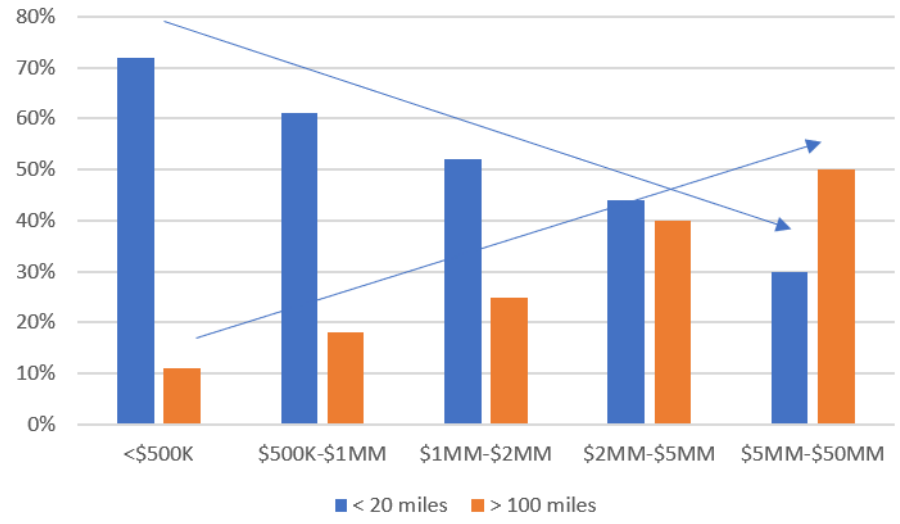


FIGURE 5: BUYER LOCATION, WITHIN 20 MILES VS. OUTSIDE A 100-MILE RADIUS



"Looking at geographic buyer trends, I think the key takeaway for sellers is to work with an advisor who matches up with their most likely buyer," said David Ryan, Advisor, Upton Financial Group in California.. "Small businesses can do well with a local business broker with local connections, and they don't need to invest in a higher priced engagement to get national reach. But larger business owners need to vet their advisor to make sure they're getting someone with the right connections in their industry, nationally or internationally."

Where Are Business Values Trending?

In Q3, median final selling prices came in anywhere from 90% to 100% of the pre-set asking price or internal benchmark. Lower middle market companies in the $2 million to $5 million and the $5 million to $50 million range achieved the highest values at 100% of benchmark.

FIGURE 6: MEDIAN PRICE REALIZED VS. ASKING PRICE, Q3 2019-2020

Multiples

Median multiples rose for Main Street businesses in the less than $500K purchase for Q3, while those for businesses selling in the $2MM-$5MM range remained the same as Q2.

FIGURE 7: MEDIAN MULTIPLE OFF PEAK

	2020 Q3	2020 Q2	2020 Q1	2019 Q3	2018 Q3	2017 Q3	2016 Q3
Median Multiple Paid (SDE)							
<$500K	2.0	1.8	2.0	2.0	2.0	2.0	2.3
$500K - $1MM	2.5	2.8	2.6	2.8	2.8	2.5	3.0
$1MM - $2MM	3.0	3.3	3.0	3.3	3.3	3.1	3.3
Median Multiple Paid (EBITDA)							
$2MM - $5MM	4.0	4.0	3.3	4.4	4.0	4.5	4.5
$5MM - $50MM	4.9	5.5	4.3	6.0	5.4	5.0	5.8

Cash at Close

Cash at close is down in a couple of sectors, with increases in seller financing and earnouts making up the difference.

FIGURE 8: CASH AT CLOSE IS DOWN

	Q3 2020				Q3 2019			
	Cash at Close*	Seller Financing	Earn Out	Retained Equity	Cash at Close*	Seller Financing	Earn Out	Retained Equity
<$500K	83%	15%	2%	-	85%	11%	2%	1%
$500K-$1MM	86%	7%	3%	-	85%	14%	1%	-
$1-$2MM	83%	11%	1%	-	93%	6%	1%	-
$2-$5MM	86%	9%	1%	-	86%	13%	-	-
$5-$50MM	81%	11%	7%	1%	88%	6%	1%	3%

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

Meanwhile, time to close has increased year over year, jumping by 60 days in the smallest Main Street sectors.

FIGURE 9: TIME TO CLOSE

	Q3 2020		Q3 2019	
	Months to Close	LOI to Close	Months to Close	LOI to Close
<$500K	8	2	6	2
$500K-$1MM	10	3	8	3
$1-$2MM	10	3	9	4
$2-$5MM	9	4	8	4
$5-$50MM	10	5	10	4

"Delays could be driven by interruptions in normal work patterns caused by COVID-19, or we could be seeing the results of the temporary time-out many buyers took after the pandemic hit," said Gary Rogers, Owner of Kingley Group. "Some buyers pumped the breaks on active deals, only to be spurred on by CARES Act incentives, low interest rates, or better-than-feared business performance."

Owners Retiring But Not Planning

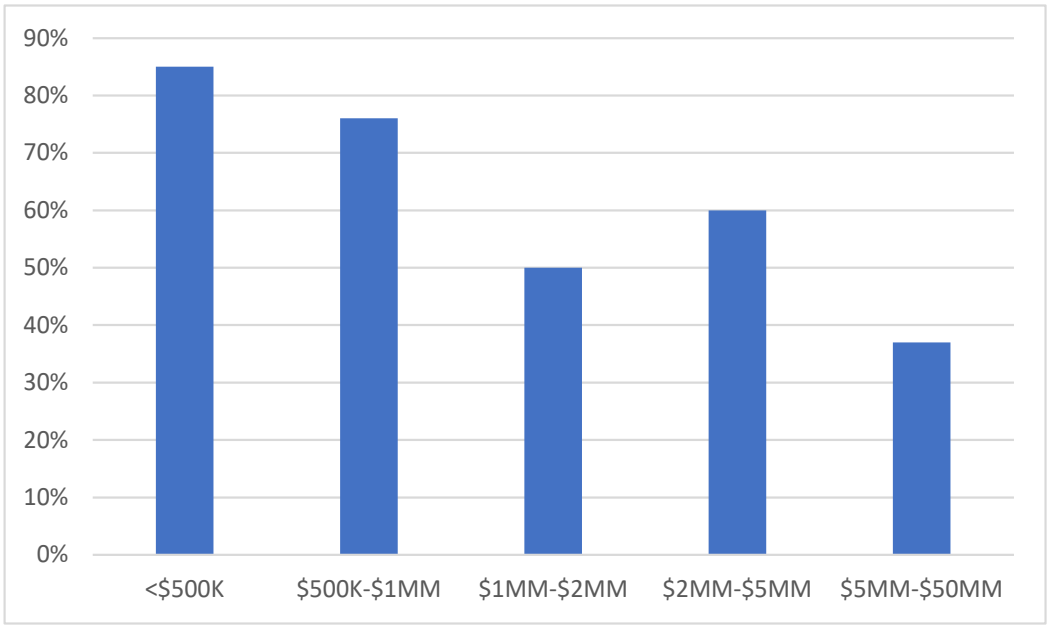
Retirement continues to fuel the supply of businesses for sale. Burnout is an issue, as sellers decide they don't have the drive to push through to the end of the pandemic. New opportunities are also cropping up as a motivating factor, suggesting that growth-minded entrepreneurs see blue sky ahead in other ventures.

FIGURE 10: TOP 2 REASONS SELLERS WENT TO MARKET

<$500K	Retirement **38%**	New Opportunity **17%**
$500K-$1MM	Retirement **67%**	Burnout **12%**
$1MM-$2MM	Retirement **69%**	Burnout **10%**
$2MM-$5MM	Retirement **65%**	New Opportunity **9%**
$5MM-$50MM	Retirement **60%**	New Opportunity **15%**

Even though retirement is far and away the most common reason that sellers go to market, most business owners are doing little to no exit planning. The smaller the business, the less likely owners are to plan. Of those owners who did plan, most started less than a year before putting their business on the market.

FIGURE 11: OWNERS WHO ENGAGED IN NO FORMAL PLANNING PRIOR TO ENGAGEMENT TO SELL



What Are They Buying?

Interest in pandemic-proof businesses is extremely high.

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Notably, Main Street restaurants are still selling, despite the way the food service industry has been impacted by the pandemic. In the lower middle market, construction/engineering, business services, and manufacturing topped transaction trends.

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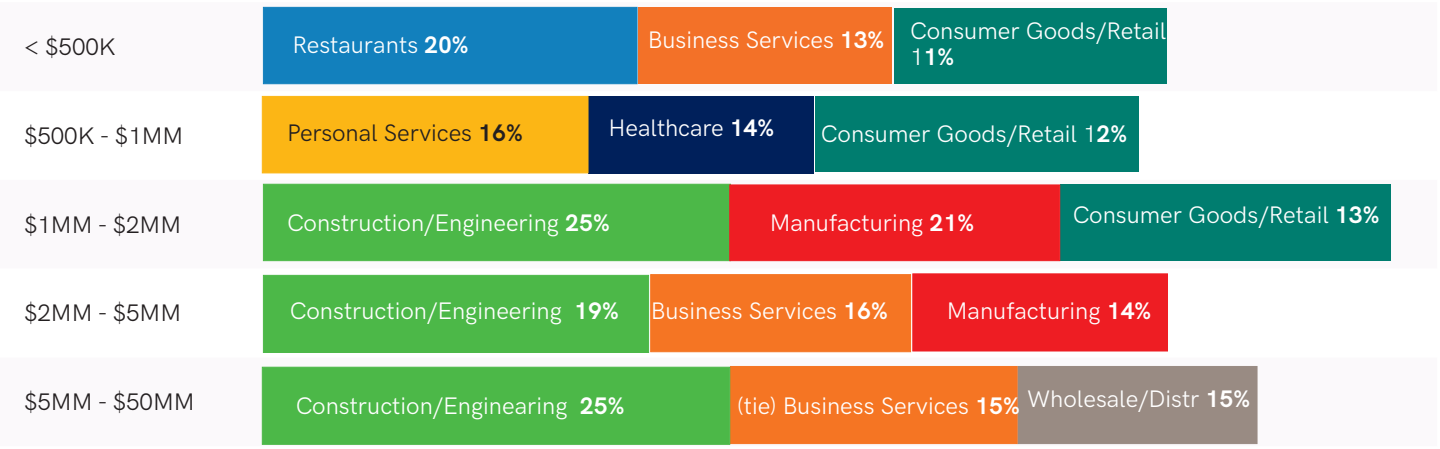
FIGURE 12: TOP 3 INDUSTRIES BY MARKET SECTOR



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.