Q4 2020

MARKETPULSE

INTERNATIONAL BUSINESS BROKERS ASSOCIATION | M&A SOURCE | FOURTH 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 Q4 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 Q4 2020 survey was conducted January 1-17, 2021 and was completed by 363 business brokers and M&A advisors. Respondents completed 256 transactions this quarter. This is the 35th edition of this report.

FIGURE 1: MARKET SEGMENTS STUDIED

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

~40%

advisors report delays due to PPP uncertainty

PPP Loans Stalling Some Transitions

The latest data from the Market Pulse survey of business brokers and M&A advisors suggests that PPP loans are proving to be an obstacle in roughly half of business transitions.

For businesses with PPP loans in the Main Street market, advisors say 41% have had closing delays due to uncertainty around their PPP status, 30% are having trouble getting to close due to risk allocation issues, and 10% are up against lenders who won't fund a transaction with outstanding PPP loans.

In the lower middle market, where roughly 40% of businesses have been affected, the outcomes are similar: 42% have closing delays, 31% face risk allocation issues, and 8% can't get lender support due to PPP loans.

"The SBA has issued guidance around when and how PPP borrowers can proceed with a change of ownership, but uncertainty prevails," said Randy Bring, Senior Associate, of Transworld Business Advisor. "There's still a lot to consider in terms of structuring, negotiating, and executing deals when outstanding PPP loans are involved."

Tax Plan Triggers?

Overall, advisors are optimistic that the M&A market will return to pre-pandemic conditions in 2021. In the lower middle market, 17% of advisors believe we're "already there." However, 22% predict market conditions won't recover until 2022 or later.

Main Street brokers are slightly less positive. Only 10% believe conditions have already recovered, while 33% believe we won't have a full turnaround until 2022 or later.

Meanwhile, advisors are reporting an uptick in new clients coming to market, and they expect that trend will continue in Q1 2021.

"One of the chief concerns right now is that the Biden administration will follow through on campaign plans and increase capital gains taxes. The Biden plan would effectively double the capital gains rate for businesses valued at more than a million dollars," said Scott Bushkie, president of Cornerstone Business Services. "We're expecting a bump in activity as sellers go to market now in hopes of avoiding those increases."

"Selling your business is a massive decision, and we don't want to push people into it on hypotheticals and maybes," added Carrie Duvall, Broker Owner of 1st & Main Partners. "But if you expect to exit in the next few years anyway, it probably makes sense to accelerate those plans."

"Any business owner who was thinking about selling in the next few years should start talking to their advisors now, emphasis on NOW," said Sam Thompson, Transitions in Business. "It takes an average of nine months to sell a business, so we don't have a lot of time to waste, since many believe tax increases might go into effect January 1, 2022."

"We just don't know how fast the administration is going to move," said Thompson. "Economic recovery will be an early priority, but then again, the pandemic has driven a lot of government spending, and that could drive demand for new tax dollars."

Sellers Market

Seller-market sentiment returned to Q1 2020 levels or better in three of the five market segments. Advisors indicate that sellers have the advantage in the lower middle market, where seller-market sentiment exceeds 50%.

Seller sentiment is recovering, although it still remains roughly 20+ percentage points off peak in all sectors. The highest seller-sentiment in the Main Street market was last seen in Q1 2018 with a 72% score in the $1MM-$2MM sector (now at 46% in Q4 2020). Peak seller-sentiment in the lower middle market was last seen in Q1 2015 at 86% in the $5MM-$50MM sector (now at 63% in Q4 2020).

FIGURE 2: SELLERS MAINTAIN ADVANTAGE IN LOWER MIDDLE MARKET, ADVISORS SAY

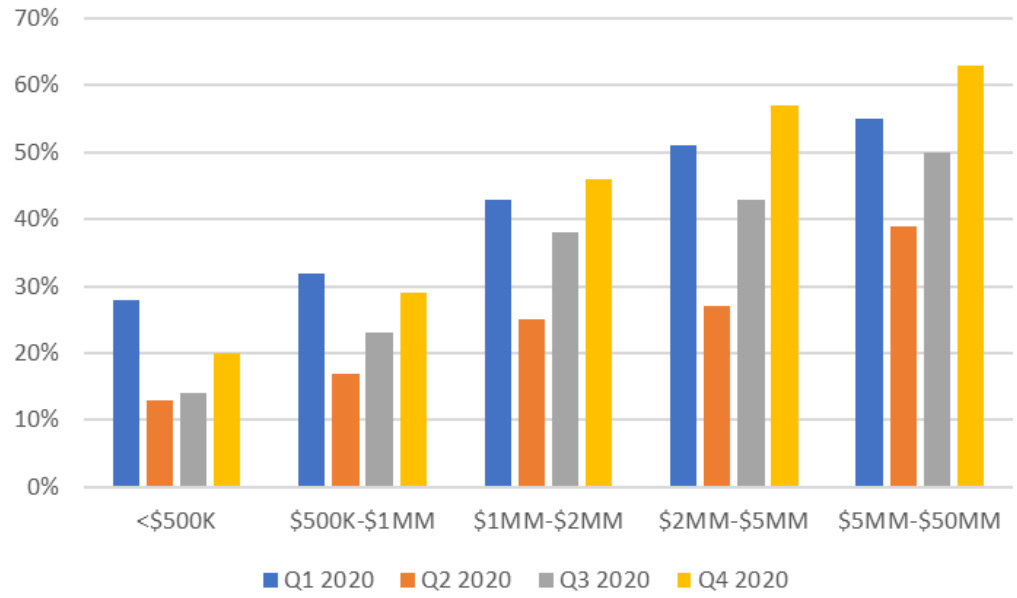
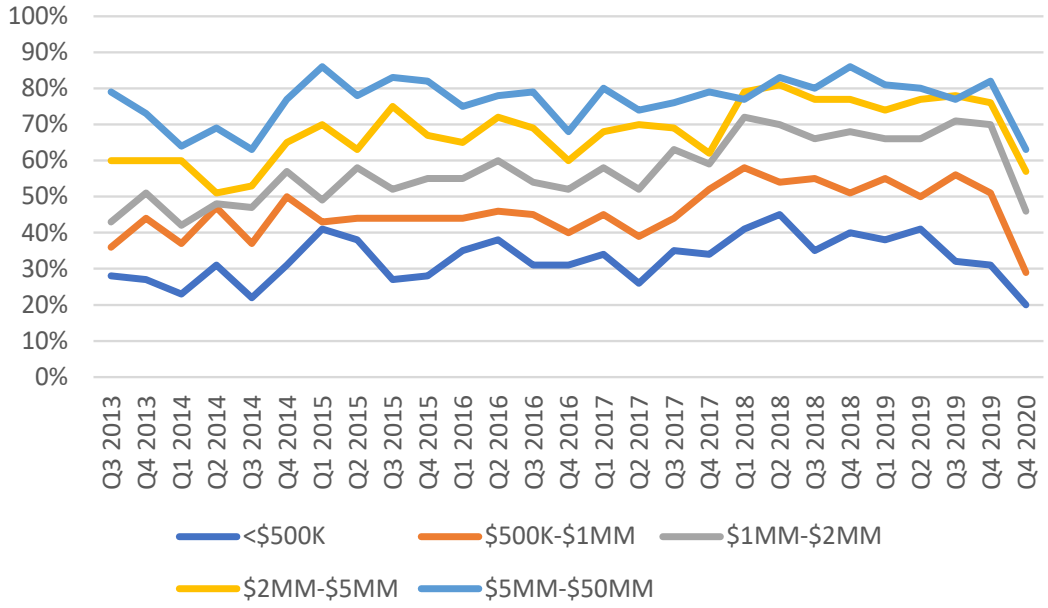


FIGURE 3: SELLER MARKET SENTIMENT, HISTORICAL TRENDS



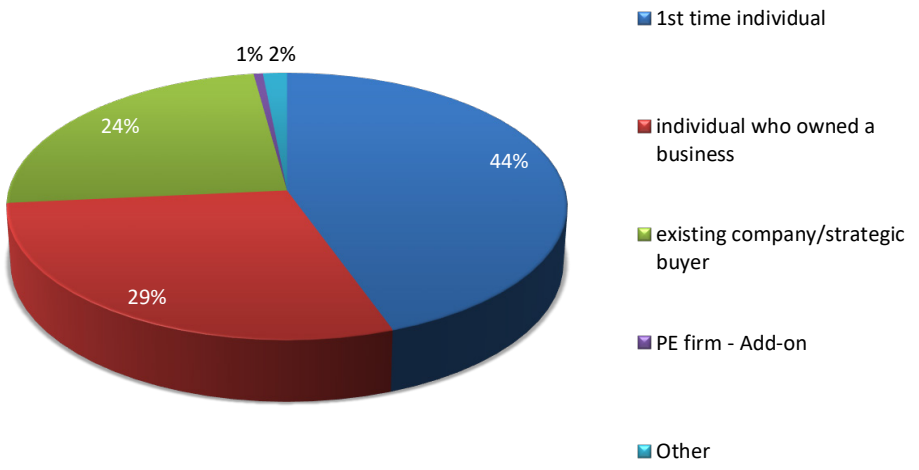
73%

Buyers were Individuals when <$2M Purchase Price

2020 Active Buyers

First time buyers dominated the Main Street market, followed by serial entrepreneurs and existing companies. In the Main Street market, individuals made up 73% of business buyers (44% first time buyers, 29% serial entrepreneurs).

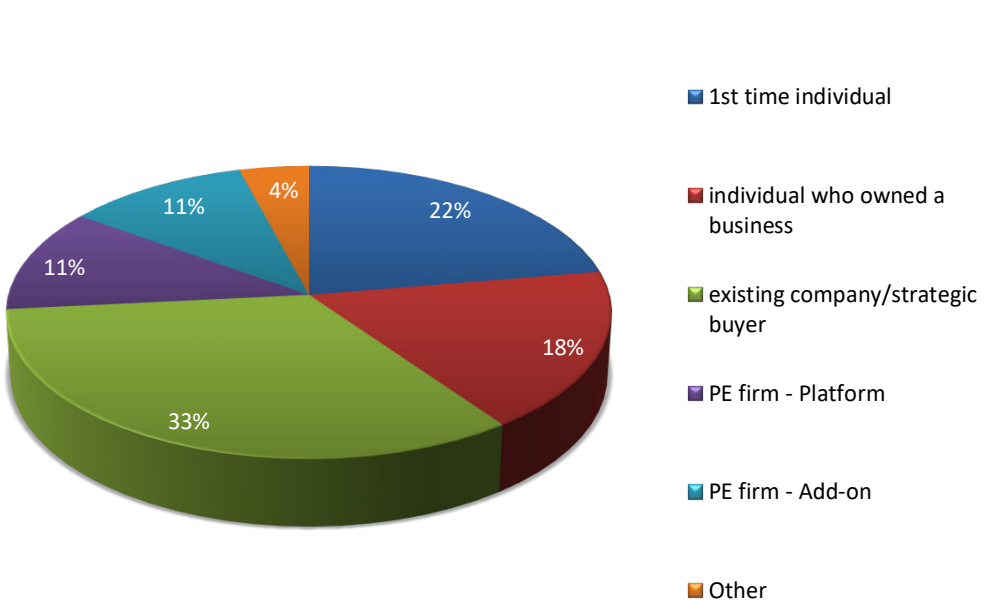
FIGURE 4: 2020 ACTIVE BUYERS - MAIN STREET



33%

Buyers were Existing Companies when >$2M Purchase Price

FIGURE 5: 2020 ACTIVE BUYERS - LOWER MIDDLE MARKET



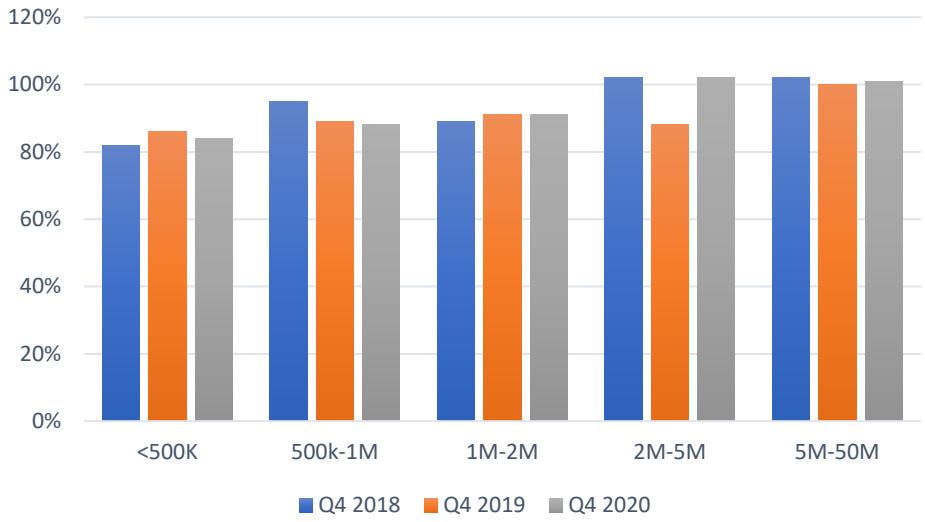
In the lower middle market, 33% of buyers were existing companies, a drop from 40% in 2019. This year, first time buyers accounted for 22% of lower middle market activity and serial entrepreneurs accounted for 18%.

Private equity firms remain active, representing 22% of lower middle market buyers in 2020—a slight downtick from last year.

Where Are Business Values Trending?

In Q4, median final selling prices came in anywhere from 84% to 102% 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 greater than 100% of benchmark.

FIGURE 6: MEDIAN PRICE REALIZED VS. ASKING PRICE, Q4 2018-2019-2020



Multiples

Multiples are slightly off peak, and yet businesses in the lower middle market continue to draw values at or even above internal benchmarks.

FIGURE 7: MEDIAN MULTIPLE OFF PEAK

	2020 Q4	2020 Q3	2020 Q2	2020 Q1	2019 Q4	2018 Q4	2017 Q4	2016 Q4	2015 Q4	2014 Q4
Median Multiple Paid in Main Street Business Sales (SDE)										
<$500K	2.0	2.0	1.8	2.0	2.0	2.0	2.0	2.3	2.0	2.0
$500K - $1MM	2.8	2.5	2.8	2.6	2.8	2.8	2.5	2.8	2.5	2.9
$1MM - $2MM	3.0	3.0	3.3	3.0	3.3	3.3	3.1	3.3	3.3	3.0
Median Multiple Paid in Lower M&A Transactions (EBITDA)										
$2MM - $5MM	4.3	4.0	4.0	3.3	4.3	4.3	4.3	4.8	4.0	4.6
$5MM - $50MM	5.0	4.9	5.5	4.3	5.8	5.8	5.5	5.5	5.1	5.0

"Volume was down in 2020 just as with other times of business downturns. But unlike during times of recessions, multiples actually stayed strong, at least for businesses that were able to weather the impact of COVID-19," said Walt Lipski, Upton Financial Group Inc. "It comes down to supply and demand. The spread of quality sellers and buyers widened significantly in 2020, so there was competition at the table. Businesses that were relatively pandemic proof got good structures and multiples."

"Businesses impacted by COVID are still selling in this market," continued Upton Financial Group Inc.'s David Ryan. "One structure we're seeing is that buyers are basing multiples on current performance and then structuring an earnout based on the seller's 2019 value."

Financing Deals in 2020

Sellers continue to get the majority of cash at close. In this quarter, owners got 81% or more cash at close with most of the balance being seller financing, along with some earn outs and retained equity to close the valuation gap.

FIGURE 8: PORTION OF SALE RECEIVED AS CASH AT CLOSE

	Q4 2020			
	Cash at Close*	Seller Financing	Earn Out	Retained Equity
<$500K	83%	11%	2%	1%
$500K-$1MM	84%	10%	3%	1%
$1-$2MM	86%	6%	3%	1%
$2-$5MM	86%	5%	5%	1%
$5-$50MM	81%	9%	5%	4%

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

Time to Close

The average time to sell a business remains relatively consistent with Q4 last year, increasing only slightly upward. Of that, roughly 60 to 120 days are spent in due diligence and execution, after a signed letter of intent.

FIGURE 9: AVERAGE TIME TO CLOSE EDGES CLOSER TO 9 MONTHS

	Q4 2019	Q4 2020	Q4 2020
	Months to Close	Months to Close	Months LOI to Close
<$500K	7	7	2
$500K-$1MM	7	7	3
$1-$2MM	9	9	3
$2-$5MM	9	10	4
$5-$50MM	11	11	4
avg.	*8.6*	*8.8*	

Advisors expected deal pace to slow down this year with the move to remote due diligence, but that has not been the case for some firms. These firms have actually seen due diligence speed up as there are fewer quality deals on the market and buyer reps aren't traveling as much. Thus, many advisors found that they had an easier time in keeping things moving forward.

Exit Planning

Retirement continues to fuel the supply of In 2020, nearly half (49%) of all small business sellers were planning to retire. Yet even though retirement leads as the number one reason for sale, most buyers do not engage in a proactive planning process, particularly in the Main Street market. Generally, the smaller the business, the less likely the owners are to do any planning prior to going to market.

Of the sellers that do plan ahead, most are still moving through the exit planning process at a rapid pace, with less than a year between initial consultation and market listing.

FIGURE 10: REASONS SELLERS WENT TO MARKET IN 2020

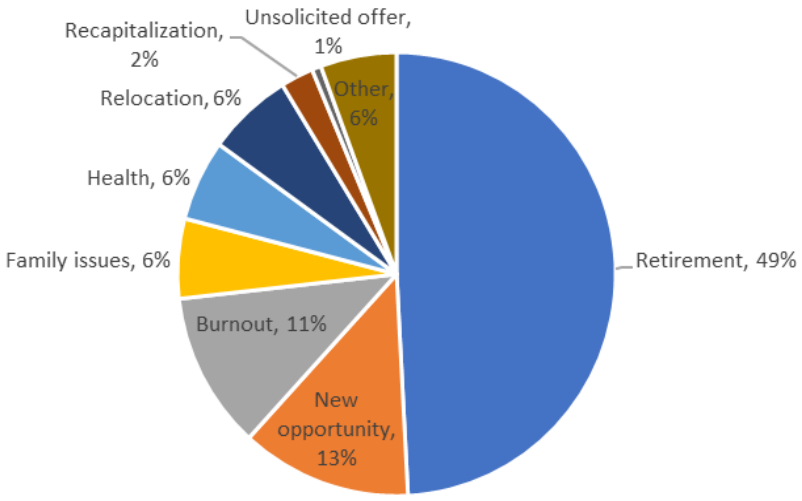
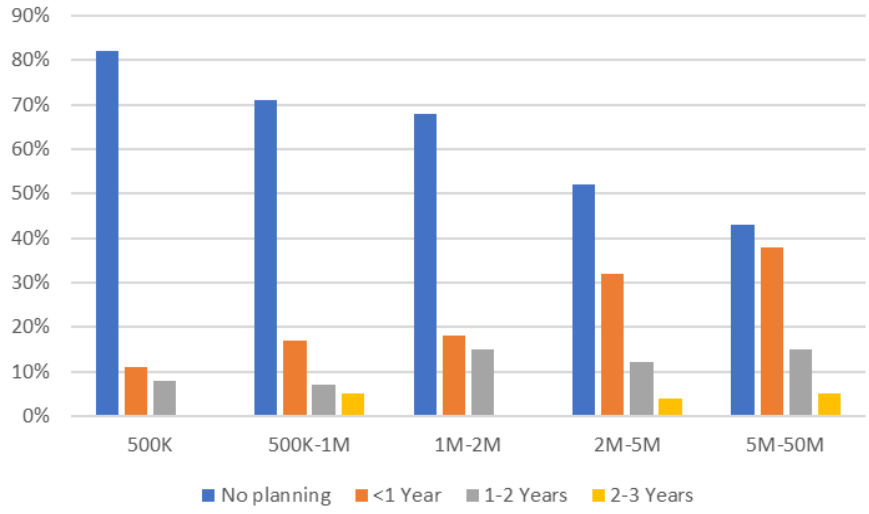


FIGURE 11: PROACTIVE EXIT PLANNING



"As business brokers and M&A advisors, we need to find a way to get the conversation started with business owners earlier in the process," said Lisa Riley, Principal of Delta Business Advisors. "The vast majority of owners need a successful sale to live their ideal lifestyle, making this one of the most important financial transactions of their life."

"Yet too many sellers are moving into the sale process without any planning, and we continue to see the same two mistakes that lead to deals failing which are unrealistic expectations and poor accounting records," Riley continued. "We can help owners avoid these mistakes if they would start the process sooner, they'd have a smoother experience with better results."

What Are They Buying?

Looking at data for the whole year, personal services, consumer goods/retail, and business services led the Main Street market in 2020, while manufacturing, construction/engineering, and business services led the lower middle market.

Compared to last year, we saw a slight decline in restaurant activity in the Main Street market and greater activity in consumer goods/retail for the lower middle market.

"It'll be interesting to see how restaurants and retail outlets fare in 2021 as so many have been hurt by COVID shutdowns and distancing orders. Unfortunately, many of them will be distressed sales, bringing down multiples," one participant expressed. "... These are great opportunities for companies with strong balance sheets and for individual buyers with dreams of small business ownership, believing there's no where to go but up."

FIGURE 12: MAIN STREET BUSINESS SALES BY INDUSTRY 2020

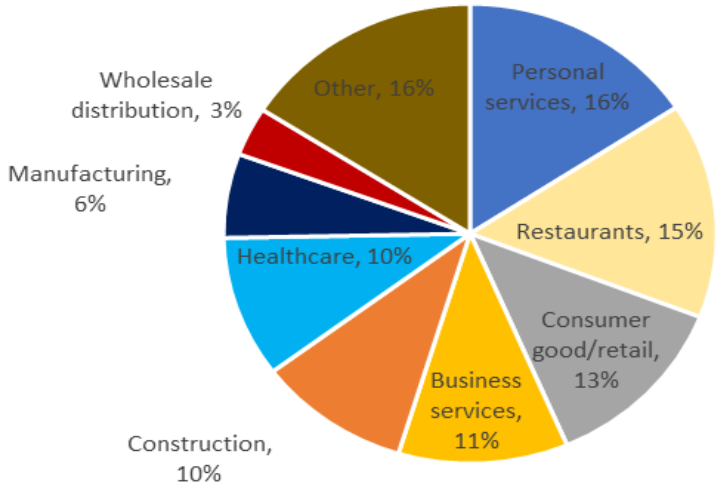
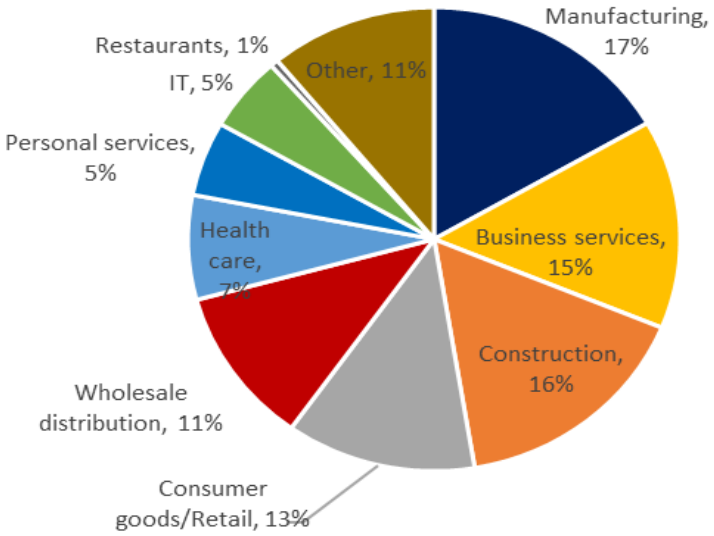


FIGURE 13: LOWER MIDDLE MARKET BUSINESS SALES BY INDUSTRY 2020



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.

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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.

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