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

<table>
<thead>
<tr>
<th>MAIN STREET</th>
<th>LOWER MIDDLE MARKET</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $500K</td>
<td>$2MM - $5MM</td>
</tr>
<tr>
<td>$500K - $1MM</td>
<td>$5MM - $50MM</td>
</tr>
<tr>
<td>$1MM - $2MM</td>
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</table>

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.”

37% deals delayed by buyer for businesses valued at > $2 million
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.

“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.

"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%
39% decline in seller market sentiment - record low!

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.”

“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.”
Where Are Business Values Trending?

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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.
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**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Q2 2020 Cash at Close*</th>
<th>Seller Financing</th>
<th>Earn Out</th>
<th>Retained Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$500K</td>
<td>76%</td>
<td>13%</td>
<td>5%</td>
<td>1%</td>
</tr>
<tr>
<td>$500K-$1MM</td>
<td>87%</td>
<td>12%</td>
<td>-</td>
<td>1%</td>
</tr>
<tr>
<td>$1-$2MM</td>
<td>85%</td>
<td>13%</td>
<td>2%</td>
<td>-</td>
</tr>
<tr>
<td>$2-$5MM</td>
<td>87%</td>
<td>10%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>$5-$50MM</td>
<td>84%</td>
<td>4%</td>
<td>5%</td>
<td>2%</td>
</tr>
</tbody>
</table>

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<thead>
<tr>
<th>Sector</th>
<th>Q2 2019 Cash at Close*</th>
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<td>1%</td>
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</table>

* 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.

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
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.

“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.”
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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