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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We see good things ahead for Main Street and the lower middle market, but there are challenges ahead,” said Lisa Riley, Principal of Delta Business Advisors. “Those companies that bounced back right away will see little to no impact on their valuations. But companies that were under-operational for a full year or more will need time to rebuild business value before a sale.”

“Buyers are cognizant that the pandemic may not be fully behind us, and new public health emergencies could be in our future. Businesses that remained fully active may actually see their valuations increase because they’ve proven they can operate during times of uncertainty,” continued Riley.
PPP Loans Complicating M&A Transactions

Three in five (62%) advisors were representing businesses with PPP loans in Q1. That’s down from 2020, when nearly 90% had clients with PPP loans.

Unfortunately, those loans are causing problems for businesses as they try to move to the closing table. For businesses on the M&A market, advisors say 42% have had closing delays due to uncertainty around their PPP status, 20% are up against lenders who won’t fund a transaction with outstanding PPP loans, and 11% are having trouble getting to close due to risk allocation issues.

“The size of PPP loans, and uncertainty regarding loan forgiveness, has created some unique complications for M&A transactions,” said Valerie Vaughn, Senior Advisor, Apex Business Advisors. “We have to determine whether SBA consent for an M&A transaction is required, whether a transaction will trigger default, and how to structure a deal – particularly when a company’s value hinges on forgiveness of that loan.”

Burnout Driving Deal Activity

While retirement still leads as the number one reason sellers go to market, burnout jumped as a leading reason 27% of sellers went to market. The number of sellers citing health issues (15%) is also higher than previous surveys, suggesting the pandemic has taken a heavy toll on business owners.

In addition, 7% of sellers went to market to get ahead of potential increases in capital gains tax. The Biden administration has indicated it will ask for significant increases in the capital gains tax rate in the near future.

FIGURE 2: TOP REASONS BUSINESS OWNERS DECIDED TO GO TO MARKET IN 2021

Meanwhile, advisors are warning that tax increases loom large.

“If Biden’s tax plans come to fruition, the capital gains tax rate could effectively double, from 20% to 39.6% for income exceeding $1 million. Right now, that means business owners need to shift their focus from maximizing total transaction price to maximizing after-tax proceeds,” said Scott Bushkie, President of Cornerstone Business Services.

“Even if a business owner is projecting 5% annual growth, they’d have to run their business another five years just to net out the same amount they could today after increased capital gains,” Bushkie continued.

Many business brokers and M&A advisors reported increased activity, with 41% reporting stronger deal flow over Q1 2020 and 33% reporting status quo.

“Business owners are already subject to a lot of stress and pressure. The pandemic supercharged that with worries about how to keep their business profitable, safety, PPP versus unemployment, talent retention, customer retention, etc. etc.,” said Gary Hallet of Gateway Business Advisors. “It’s little surprise business owners are saying ‘enough is enough.’”
Market Confidence Rebounding

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.

In fact, sellers in the $5 million to $50 million sector realized, on average, a final sale price that was 107% of benchmark. Overall, across all sectors, businesses are received 91% of benchmark in Q1 2021 (see Figure 9).

“Conditions are such that there’s still a shortage of strong performing businesses in the market. Private equity is active in the lower middle market, and SBA incentives continue to fuel activity in Main Street,” said Lisa Riley, Principal of Delta Business Advisors. “Those ‘covid proof’ business owners who pushed ahead with exit plans, despite the pandemic, are faring well.”
$5 million+ Deals Moving Fastest

Year over year, deals took longer to close in most sectors. The $5 million to $50 million sector, however, saw acceleration, with deals taking just 10 months to close.

“Deals could have been taking longer to close due to market uncertainty or due to delays caused by PPP loans,” said David Ryan, Advisor, Upton Financial Group in California.

“What’s interesting is how quickly the $5 million-plus deals moved to the closing table. When the market is competitive, like the lower middle market is right now, buyers will use speed to close as one competitive advantage in their purchase offer,” Ryan continued.

Confidence Strong

What a difference a year makes! The Q1 2020 survey, taken at the start of the pandemic shows depressed hopes for deal flow and valuation multiples. One year later, as we are hopefully come out of the pandemic, advisors are far more optimistic – expecting increases in new engagements as well as lifts in valuation.

“We have double our standard deal flow in market right now, and I’m hearing similar things from advisors around the country. People are the busiest they’ve ever been” said Scott Bushkie, President at Cornerstone Business Services.

“There are so many factors coming into play, from the number of buyers with ample investment cash, to looming tax increases, and our collective COVID-19 hangover as deals were put on hold. All signs suggest 2021 should be a robust year for Main Street and lower middle market M&A.”
Cash at Close

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

FIGURE 8: SELLER FINANCING CONSISTENT WITH 2020

<table>
<thead>
<tr>
<th></th>
<th>Q1 2021</th>
<th>Q1 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cash at Close*</td>
<td>Seller Financing</td>
</tr>
<tr>
<td>&lt;$500K</td>
<td>84%</td>
<td>13%</td>
</tr>
<tr>
<td>$500K-$1MM</td>
<td>83%</td>
<td>10%</td>
</tr>
<tr>
<td>$1-$2MM</td>
<td>83%</td>
<td>11%</td>
</tr>
<tr>
<td>$2-$5MM</td>
<td>85%</td>
<td>8%</td>
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<tr>
<td>$5-$50MM</td>
<td>87%</td>
<td>7%</td>
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</tbody>
</table>

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

A shortage of sellers is creating strong competition for deals, and that’s driving more cash at close, despite COVID and tax uncertainties ahead. We may see more earnouts in the future if businesses that are still negatively affected by the pandemic try to sell,” said Kyle Griffith, Managing Partner of The NYBB Group.

“We think earnouts will increase if burnout drives more sellers to market,” continued Griffith. “Sellers whose businesses were affected by COVID-19 may not realize what would have been their full 2019 valuation at the closing table today, but earnouts can be structured to make them whole in one to three years.”
WHERE ARE BUSINESS VALUES TRENDING?

In Q1, the average final sale price came in anywhere from 86% to 107% 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 107% of benchmark.

FIGURE 9: FINAL PRICE REALIZED VS. ASKING PRICE. Q1 2019-2021

Muliples - For Purchase Price of Q1 Businesses

Multiples climbed in the lower middle market this quarter, while still remaining below market peaks. Historically, multiples in Main Street have varied within about a 10% range.

FIGURE 10: MEDIAN multiple OFF PEAK

<table>
<thead>
<tr>
<th></th>
<th>2021 Q1</th>
<th>2020 Q1</th>
<th>2019 Q1</th>
<th>2018 Q1</th>
<th>2017 Q1</th>
<th>2016 Q1</th>
<th>2015 Q1</th>
<th>2014 Q1</th>
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<tbody>
<tr>
<td>Median Multiple</td>
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<tr>
<td>Paid in Main Street</td>
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<td>Business Sales (SDE)</td>
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<tr>
<td>&lt;$500K</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2.3</td>
<td>2</td>
<td>2</td>
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</tr>
<tr>
<td>$500K - $1MM</td>
<td>2.8</td>
<td>2.6</td>
<td>2.5</td>
<td>2.8</td>
<td>2.8</td>
<td>2.8</td>
<td>2.7</td>
<td>2.6</td>
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<tr>
<td>$1MM - $2MM</td>
<td>3</td>
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<td>3</td>
<td>3.3</td>
<td>3.3</td>
<td>3</td>
<td>3.3</td>
<td>3.1</td>
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<tr>
<td>Median Multiple</td>
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<tr>
<td>Paid in Lower M&amp;A</td>
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<tr>
<td>Transactions (EBITDA)</td>
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<tr>
<td>$2MM - $5MM</td>
<td>4</td>
<td>3.3</td>
<td>4.3</td>
<td>4.4</td>
<td>5.3</td>
<td>4</td>
<td>4.5</td>
<td>4.3</td>
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<tr>
<td>$5MM - $50MM</td>
<td>5</td>
<td>4.3</td>
<td>6</td>
<td>6.1</td>
<td>5.3</td>
<td>5.5</td>
<td>4.9</td>
<td>4.5</td>
</tr>
</tbody>
</table>
What Are They Buying?

In the Main Street market, personal services were trended throughout the sector. In the lower middle market, manufacturing and construction/engineering dominated industry transitions.

**Figure 11: Top 3 Industries by Market Sector**

<table>
<thead>
<tr>
<th>Market Sector</th>
<th>Personal Services</th>
<th>Restaurants</th>
<th>Consumer Goods</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $500K</td>
<td>19%</td>
<td>15%</td>
<td>14%</td>
</tr>
<tr>
<td>$500K - $1MM</td>
<td>Business Services 15%</td>
<td>Personal Services 12%</td>
<td>(tied) Consumer Goods 12%</td>
</tr>
<tr>
<td>$1MM - $2MM</td>
<td>Construction/Engineering 17%</td>
<td>Manufacturing 15%</td>
<td>(tied) Personal Services 15%</td>
</tr>
<tr>
<td>$2MM - $5MM</td>
<td>Construction/Engineering 24%</td>
<td>(tied) Manufacturing 24%</td>
<td>Consumer Goods 20%</td>
</tr>
<tr>
<td>$5MM - $50MM</td>
<td>Manufacturing 33%</td>
<td>Business Services 20%</td>
<td>Construction/Eng. 13%</td>
</tr>
</tbody>
</table>

Who Is Buying?

**<$500,000:** Buyers in this sector were:
- First time buyers (39%), serial entrepreneurs (34%), or existing companies (25%)
- Motivated to buy a job (40%), gain a horizontal add-on (29%)
- Located within 20 miles (63%) or more than 100 miles (21%) of the seller’s location

**<$500K-$1MM:** Buyers in this sector were:
- First time buyers (37%), existing companies (30%), serial entrepreneurs (27%)
- Motivated to buy a job (30%) gain a horizontal add-on (32%)
- Located within 20 miles (42%) or more than 100 miles (35%) of the seller’s location

**$1MM-$2MM:** Buyers in this sector were:
- First time buyers (27%) or serial entrepreneur (29%)
- Looking for a horizontal add on (40%), motivated to buy a job (27%)
- Located within 20 miles (38%) or more than 100 miles (44%) of the seller’s location

**$2MM-$5MM:** Buyers in this sector were:
- First time buyers (36%), serial entrepreneurs (28%), or existing companies (24%)
- Motivated to buy a job (28%), get better ROI than other investments (24%), gain a horizontal add-on (20%)
- Close to equally located more than 100 miles (36%), within 20 miles (28%) or within 50 miles (28%) of the seller’s location

**$5MM-$50MM:** Buyers in this sector were:
- PE firms seeking a platform deal (33%), existing companies (20%), or PE firms seeking an add-on (20%)
- Motivated to acquire a horizontal add-on (33%), vertical add-on (20%), or get better ROI than other investments (20%)
- Located more than 100 miles (80%) of the seller’s location

“A great number of potential sellers are holding off until their numbers are back to 2019 levels in hopes of getting higher valuations after the impact of COVID 19 on their business,” said G. Robert (Bob) Allen of BTI Group/Business Team. “This is definitely a sellers’ market in the lower middle market as we get multiple inquiries a day from private equity groups and family offices looking for deals. There seems to be more acquisition money available than we have seen in recent years.”
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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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