FIRMEX

Deal Flow Bulletin

Q1 2022

Bulletin Highlights

- After a record year in 2021, merger and acquisition volume is poised to keep growing vigorously. An analysis of the creation of new deal rooms on the Firmex platform predicts announcements in North America will **increase by 4%** in the first quarter of 2022, compared to a year earlier.
- In Europe, Firmex forecasts another strong quarter, **up 23% from the final quarter of 2021.** This represents a **5% decrease** from the prior year's record first quarter.
- Most merger advisors said their firms handled an above-average number of deals in 2021, and **30% said it was one of their best years ever.**
- Covid affected the business of three-quarters of the firms, although more of them said the pandemic increased, rather than decreased, transaction volume.
- In 2022, nearly **seven out of ten advisors expect their deal volume to increase.**
- The hottest sectors in the coming year are seen as technology, manufacturing, and healthcare.
- The major factors driving M&A activity continue to be the availability of capital in private equity funds, SPACs, and low-interest debt.
- Most advisors see private company valuations as above average, and only **23% expect valuations to fall in 2022.**
- When asked to name their greatest challenges in 2022, four out of five advisors picked bridging the gap in valuation expectations between buyers and sellers.

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Overview

The record-breaking pace of middle market mergers and acquisitions is on track to continue from 2021 into 2022. The momentum is evident in the high number of deal rooms that have been created on the Firmex platform at the end of 2021, signaling transactions to be announced in early 2022. And it's reinforced by our survey of global merger advisors.

Low interest rates and capital from private equity funds are spurring more aggressive bidding by an ever-growing cast of buyers. Business owners are not only tempted by the high prices, they are also motivated to sell after confronting their vulnerabilities in the depths of the coronavirus pandemic. For merger advisors, the greatest uncertainty in the market is whether the current valuation levels can be sustained. Accordingly, they expect their greatest challenge in the coming year to be bridging the price expectations of buyers and sellers.

Regardless, they expect to be busy. When asked what influenced his firm's volume in 2021, Joe De Tuba, the owner of TBD Capital in Toronto, said simply, "No Marketing. Operating at full capacity."

Observations

Deals from 2020 were delayed into 2021 due to Covid. And deals for 2022 were pulled into 2021 due to the expectation of taxes.

— Pitt Means, founding partner, Berntson Porter Corporate Advisory, Bellevue, Washington

Strong appetite from buyers drove deals, as did owners of businesses that had been performing well, deciding to sell on an upswing.

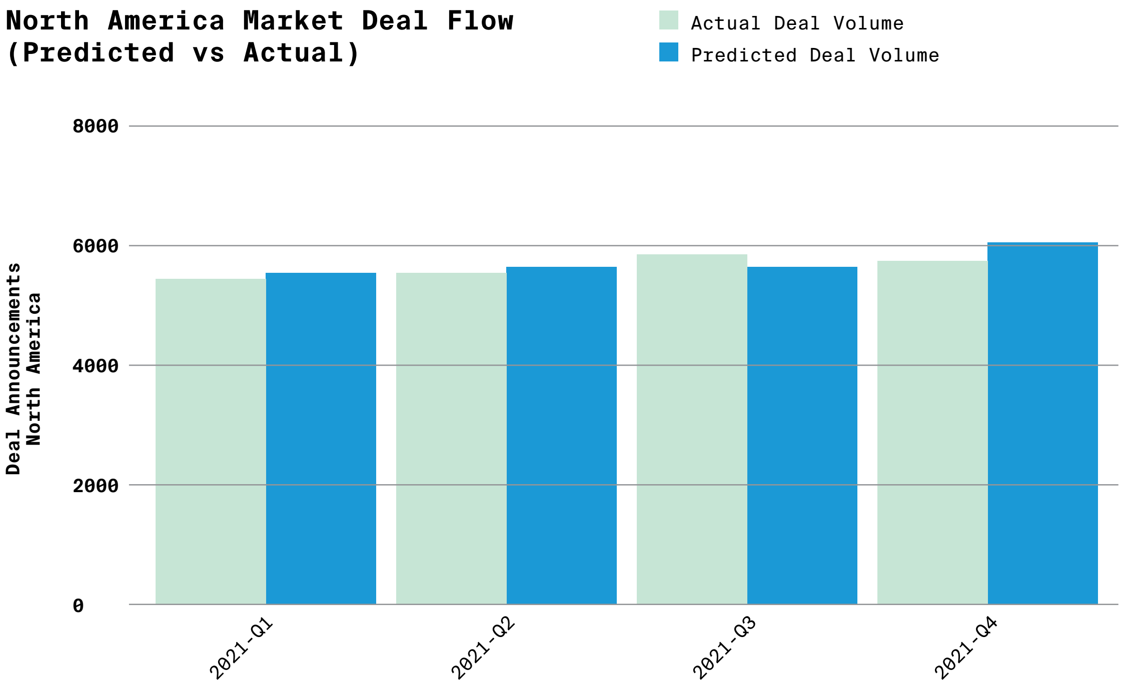
— Jim Friesen, founder of Portage M&A Advisory, Grimsby, Ontario.

Entrepreneurs increased their attention to M&A, with the high multiples, remarkable liquidity, and increasing PEs activity. Also, the Covid pandemic has convinced some older entrepreneurs to retire.

— Guidalberto Gagliardi, founder and CEO of Equity Factory, Milan, Italy

About the Deal Projections

The forecasts of first quarter 2022 deal volume are based on activity on the Firmex Platform, one of the most widely used virtual data room providers. Each year, more than 15,000 rooms are created on Firmex for prospective buyers and sellers to exchange confidential information in due diligence reviews. The level of deal room creation has proven to be a reliable indicator of future M&A activity.



This year, Firmex is introducing a projection for deal announcements in Europe to complement its North American projections. The first quarter 2022 forecast is compared to actual deal announcements for the fourth quarter of 2021 compiled by S&P Capital IQ.

About the Survey

The insights about market dynamics are drawn from an online survey in December 2021 of 123 investment bankers, business brokers, and other professionals involved in middle market mergers and acquisitions.

The most common respondent was an investment banker working in the United States who is the head of a firm with less than 20 employees that typically handles deals below $50 million.

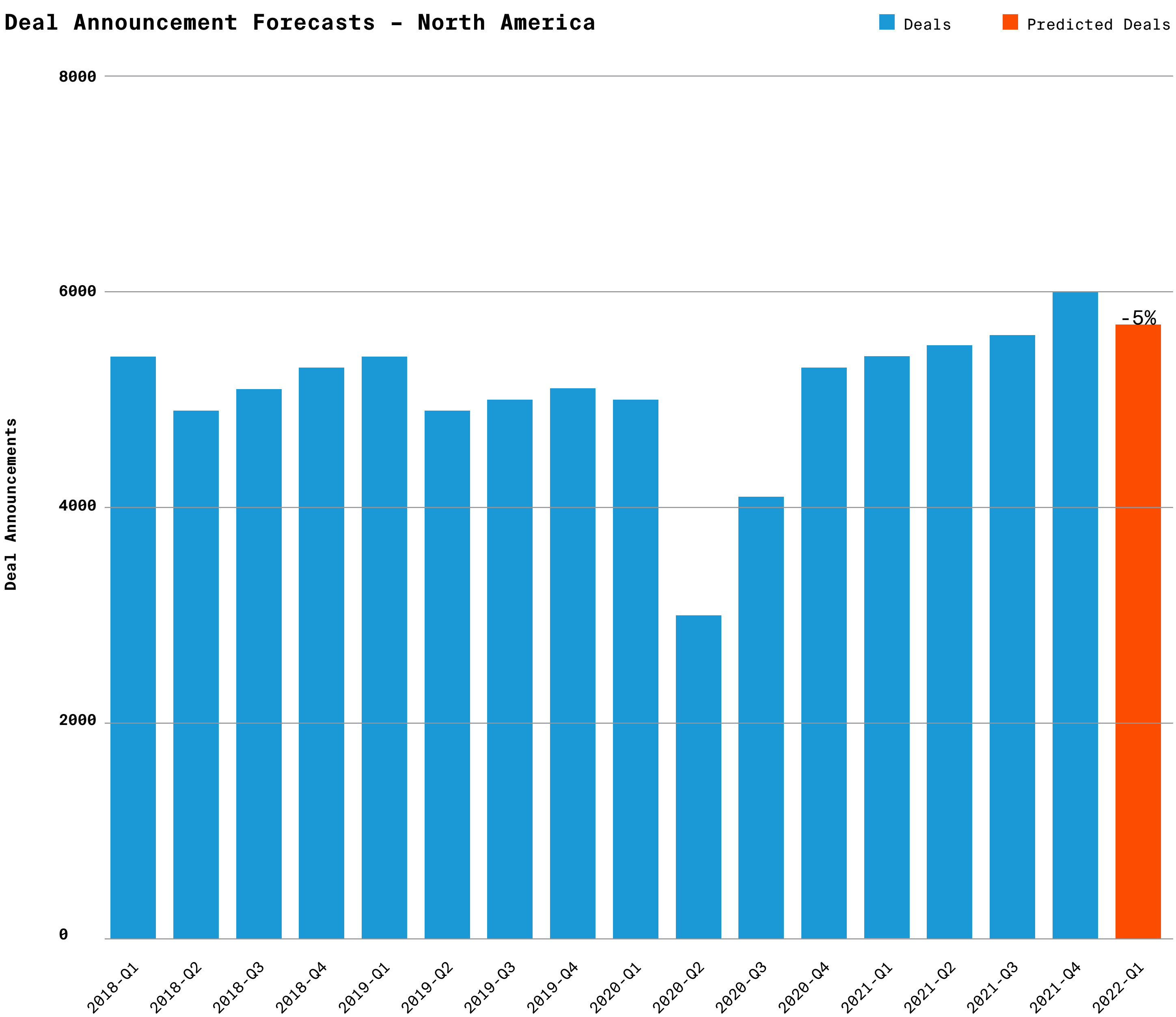
The most common industry specialties were technology, media, and telecommunications; manufacturing; and healthcare. Nearly half the respondents described themselves as generalists.

There was quite a diversity of respondents as well. Lawyers, business development executives, and others not directly doing deals made up 29%. Employees of firms with more than 100 people made up 13%. And 8% regularly handle deals valued at $100 million and up. See the appendix for detailed information on respondents.

The Firmex Deal Flow Forecast:
North America Deal Announcements

Coming off the end of a torrid year for M&A, Firmex projects the number of deal announcements in the first quarter of 2022 will decline by 5% from the final quarter of 2021. Still, the first quarter of 2022 will see 5% more deals than the same period in 2021.

Last year, 18,294 deals were announced in North America, up 31% and an all time record. Of course, economic activity of all sorts nearly froze in the spring of 2020 amid the initial outbreak of Covid-19. By the fourth quarter of 2021, the deal pace had rebounded to just above the level in the last quarter of 2020.

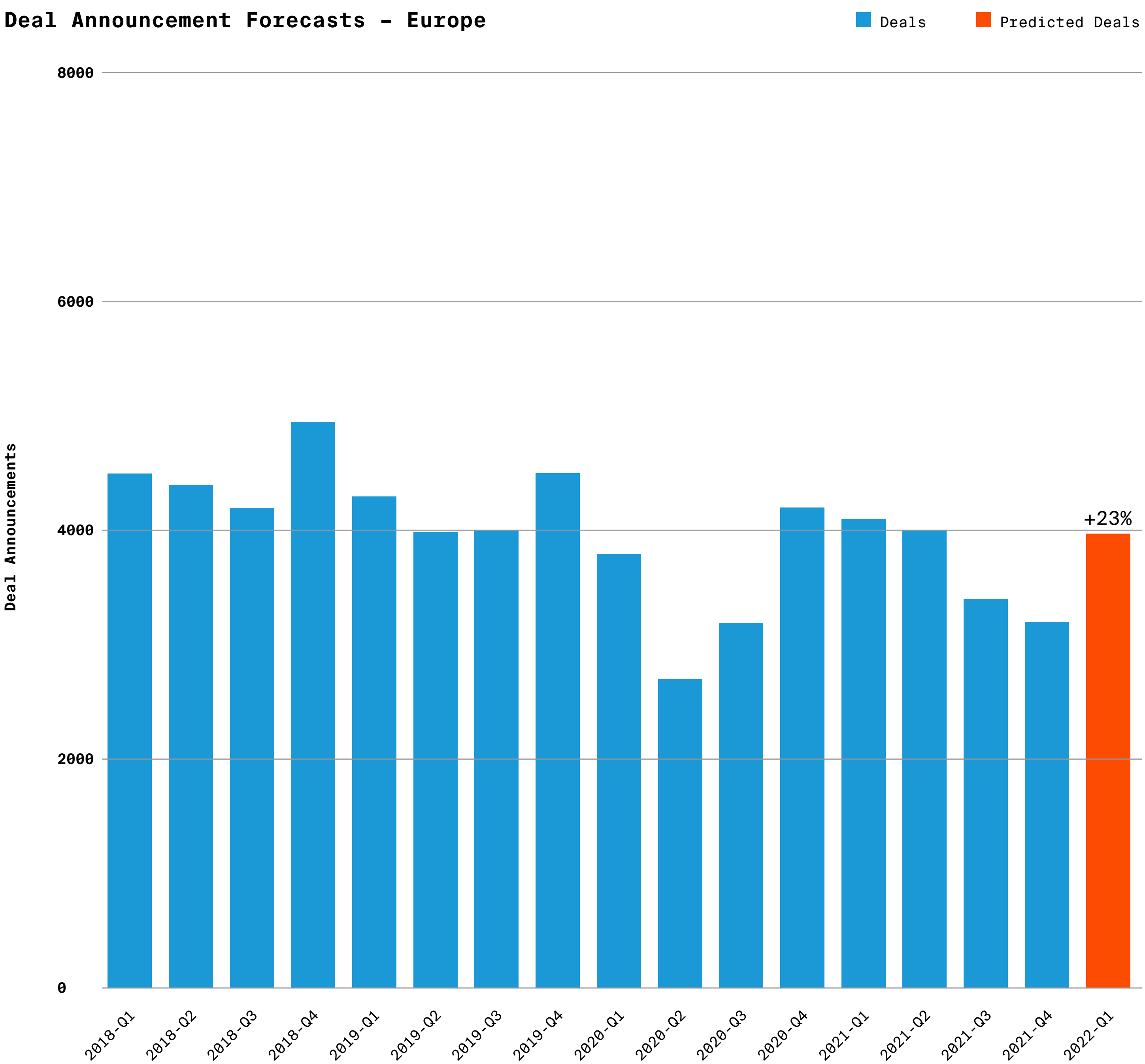


Source: Firmex analysis (4th quarter 2021, First quarter 2022), S&P Capital IQ (2018 - 2021).

The Firmex Deal Flow Forecast: Europe Deal Announcements

In Europe, deal flow has been somewhat slower to rebound than in North America, but the pace is starting to pick up. Firmex projects the number of deal announcements in the first quarter of 2022 will increase by 23% from the final quarter of 2021. That represents a 5% decrease from the prior year's record first quarter.

For the full year, announced deals in Europe increased by 8% in 2021 over 2020. Amid the pandemic, European deals had fallen by 17% in 2020 from 2019.

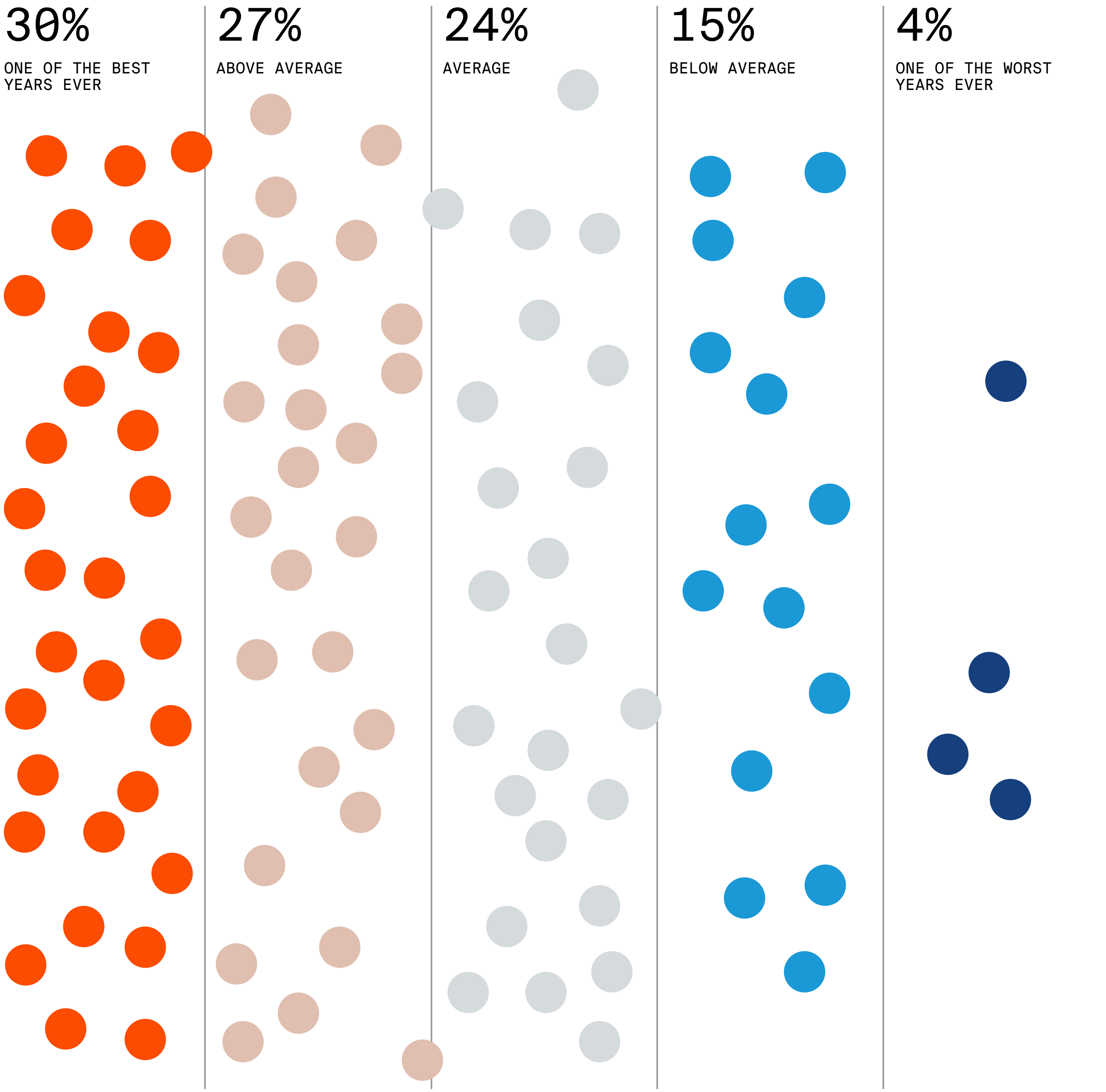


Source: Firmex analysis (First quarter 2022), S&P Capital IQ (2018 - 2021)

The Advisor Survey: Advisory Firm Deal Volume

The survey of dealmakers shows that the record total volume of transactions has buoyed most of the firms in the industry. Some 57% said their firms handled more deals than average, and 30% said 2021 was one of the best years ever. Only 20% said volume at their firms was below average.

Looking back at 2021, how would you characterize overall deal volume at your firm?

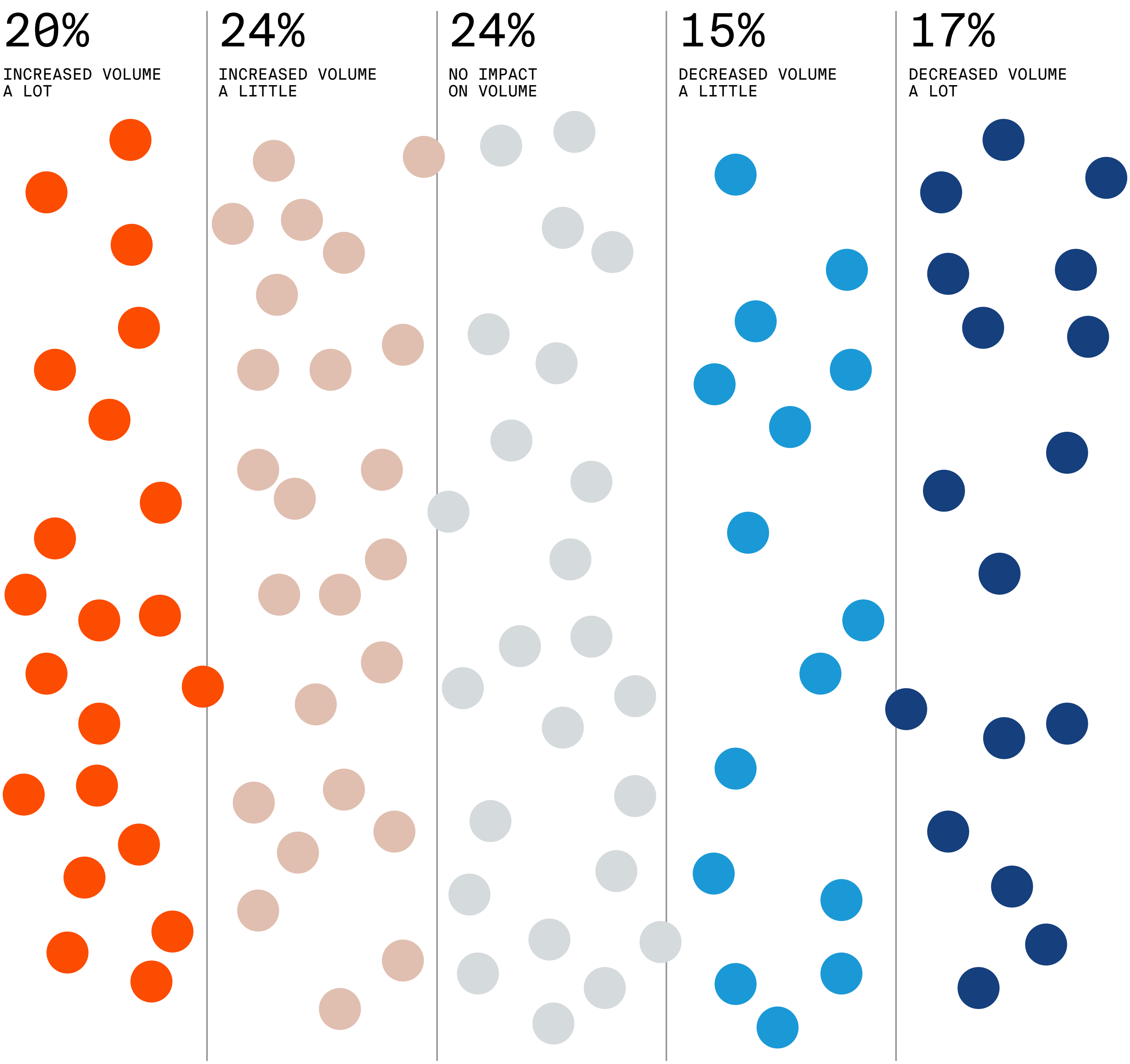


The Advisor Survey:
Impact of the Pandemic

Advisors found the Covid-19 pandemic a boon or bane to business, depending on their location and industry focus. The largest group, 44%, said the pandemic increased deal volume, while 32% said it decreased volume.

"Deals that were on hold because of the pandemic came off hold in 2021," said Bryan Ducharme, a managing partner of Venture 7 Advisors in Burlington, Vermont. **"Both clients who did well and those clients who were burned out from pandemic accelerated sale plans."**

In 2021, how did the Covid-19 pandemic affect deal volume at your firm?



Expectations for 2022

Merger advisors are largely bullish that their good times will continue. Nearly seven out of ten expect their deal volume to increase in 2022, while only 15% predict their volume to fall.

"The low cost of capital and high stock prices (bringing high valuation) are driving new acquisitions," said Aaron Solganick, the CEO of Solganick & Co., a technology-focused investment bank.

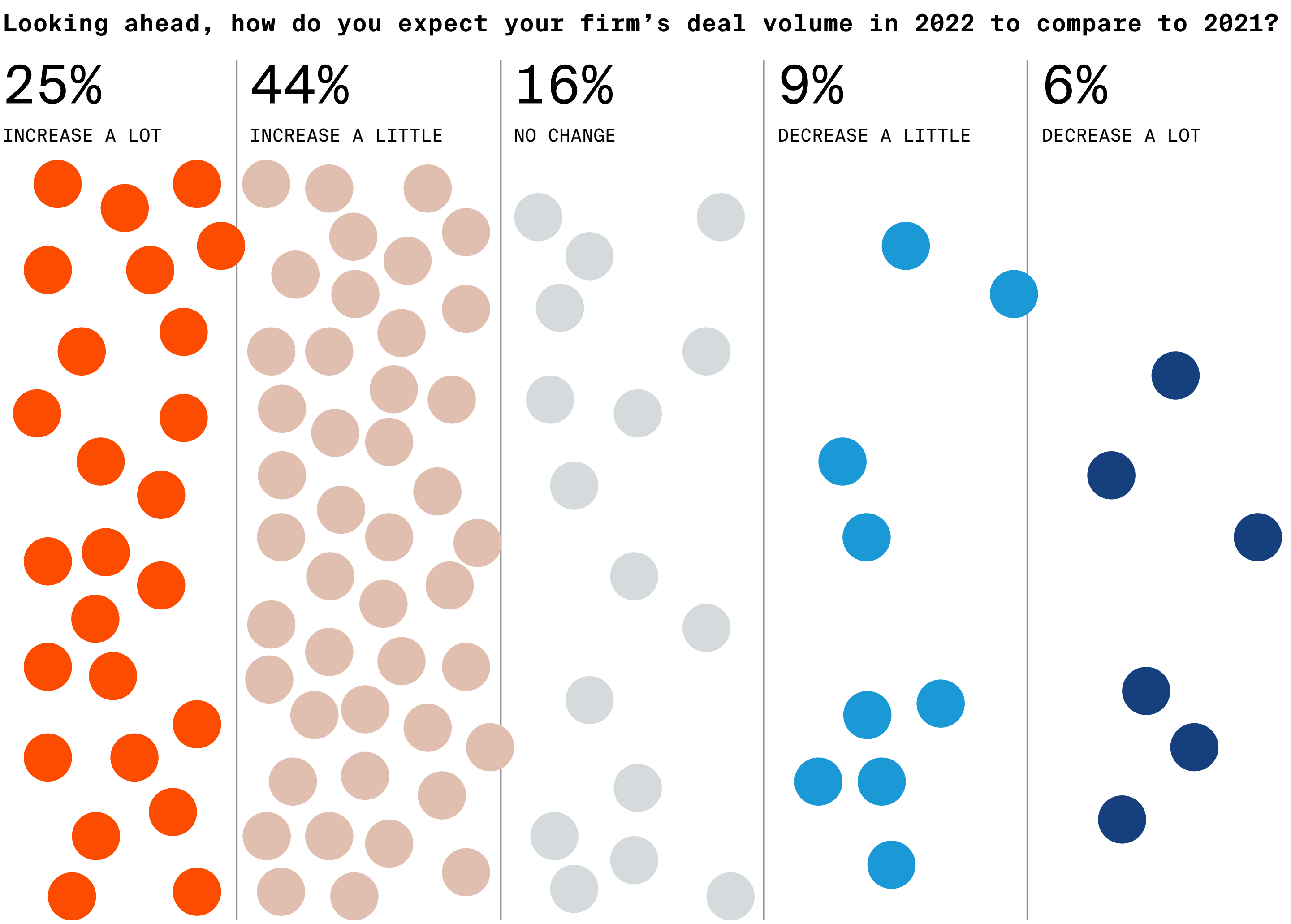
Most of the advisors agreed. When asked the factors likely to increase volume in 2022, more than half said the capital available from private equity funds and SPACs. And more than a third pointed to the availability of debt financing. (Respondents could choose more than one factor.)

Some 30% said sharp increases in valuations would encourage deal volume, while 8% said there would be more deals because company values would fall sharply.

The advisors said business owners are choosing to sell now because of a bevy of frustrations. These include supply chain issues (30%), tax changes (19%), and labor shortages (15%). Other factors cited include "board fatigue and competitive forces," "perception of business risk increase," and "retirements."

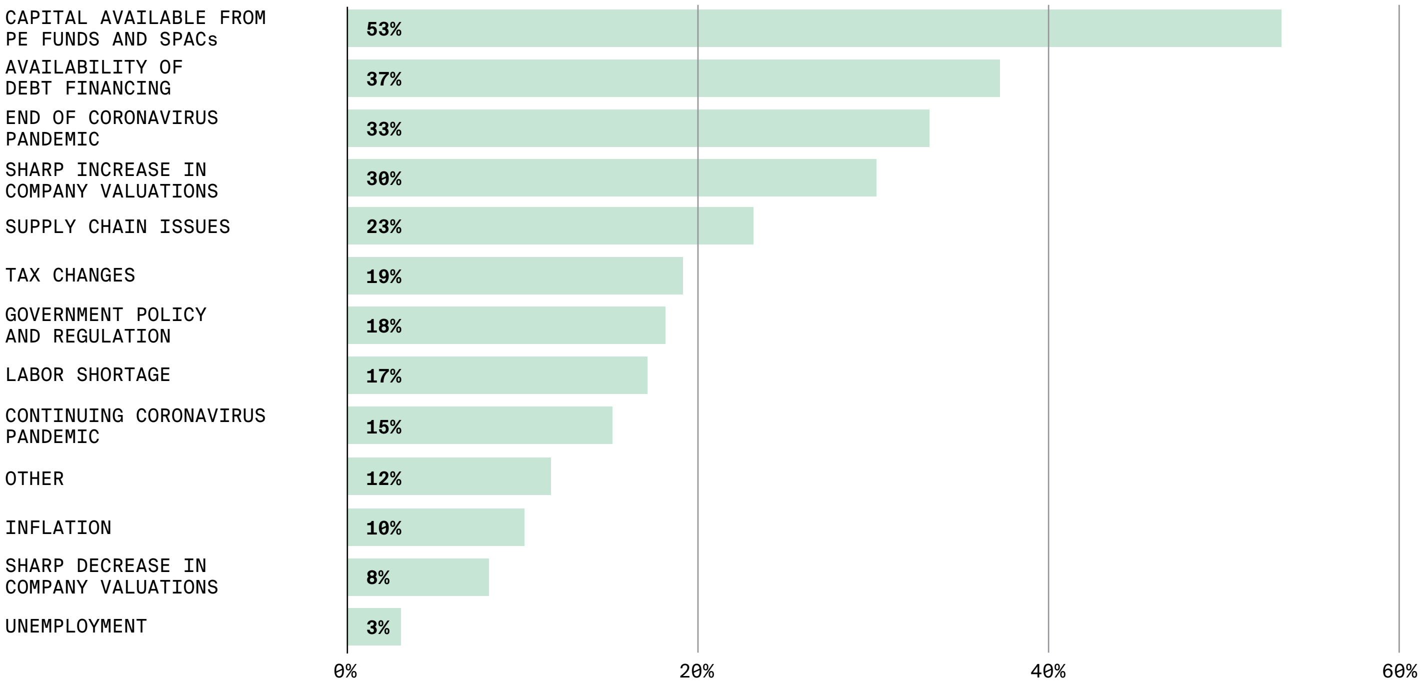
The advisors, a largely optimistic bunch, as we've said, were asked the factors most likely to depress deal volume. Their top concerns were the continuing coronavirus pandemic (44%), supply chain issues (41%), inflation (40%), and labor shortages (29%).

Buyers are becoming more selective, suggested John A. Bova, a consultant to private equity funds at RGP. **"The best valuations are going to the best companies,"** he wrote. **"Inflation, supply chain issues, and other issues that arise from having average management in place, will make companies rethink going to market."**

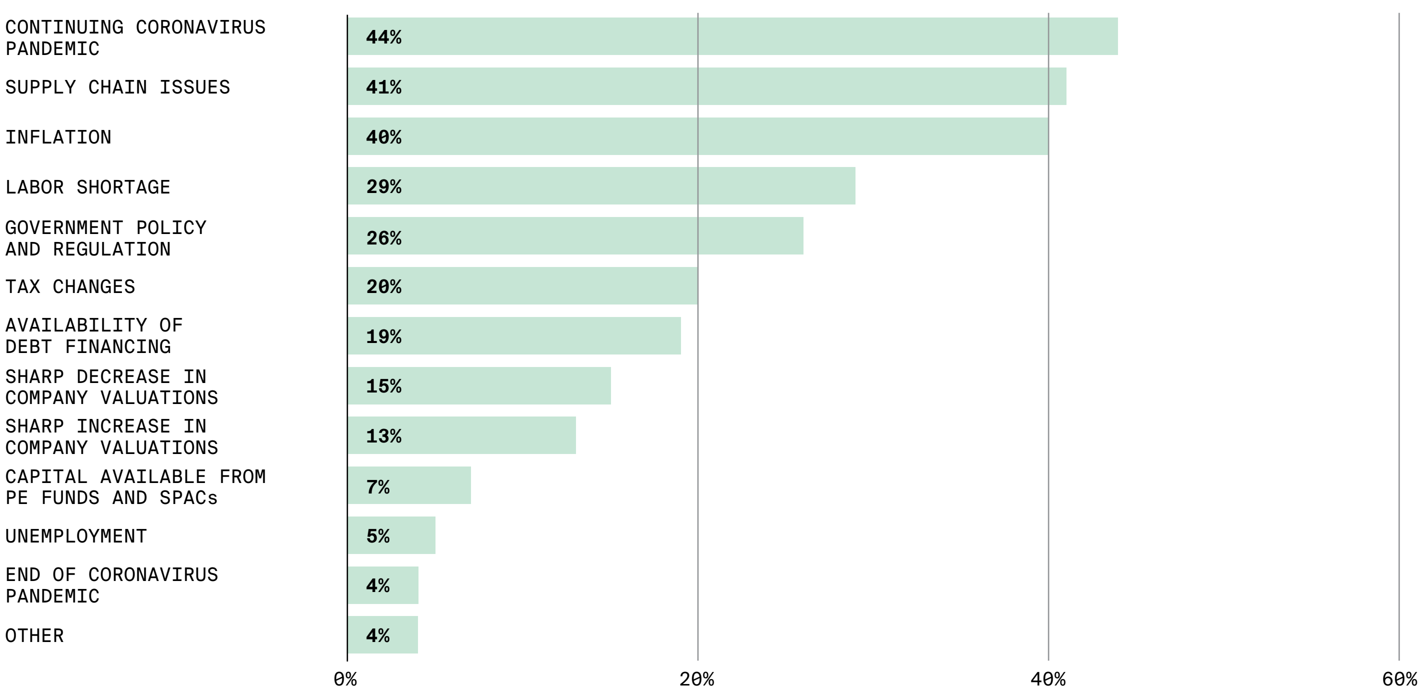


Expectations for 2022 *CONITINUED*

In 2022, which of these factors are most likely to encourage increased deal volume? (Select up to three.)



In 2022, which of these factors are most likely to depress deal volume? (Select up to three.)



Valuations

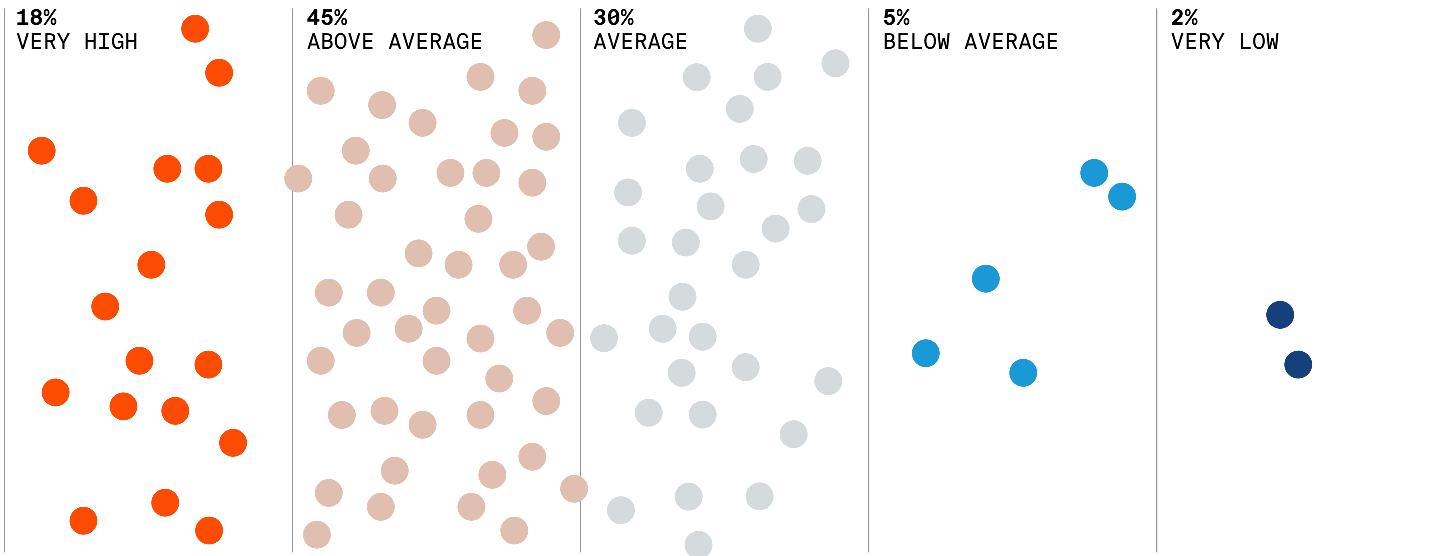
There's no question that private company valuations have soared. In fact, only 7% of the respondents said companies were selling at below-average values. By contrast, 63% see valuations as above average, with 20% saying they are very high.

As for the coming year, there is more of a divided view. The largest portion of the advisors (42%) said that valuations have hit a plateau and won't change in 2022.

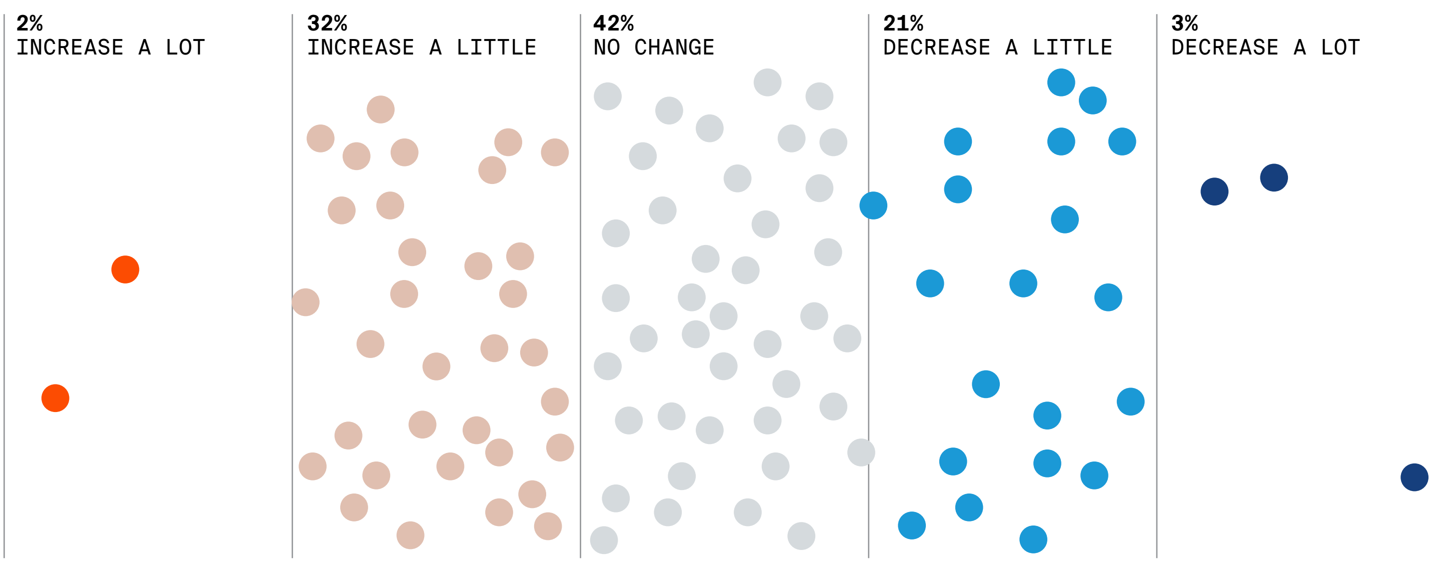
Of the rest, 34% say prices for private companies will continue to rise, while 23% say they will fall.

"The amount of PE money out there right now is insane," said Ed Bryant, the CEO of Sampford Advisors in Ottawa. **"If a company has good growth metrics, there is a very competitive process that drives value up significantly."**

In 2021, how would you describe the valuation of companies in deals your firm was involved in?



In 2022, how do you expect company valuation to change for deals your firm is involved in?

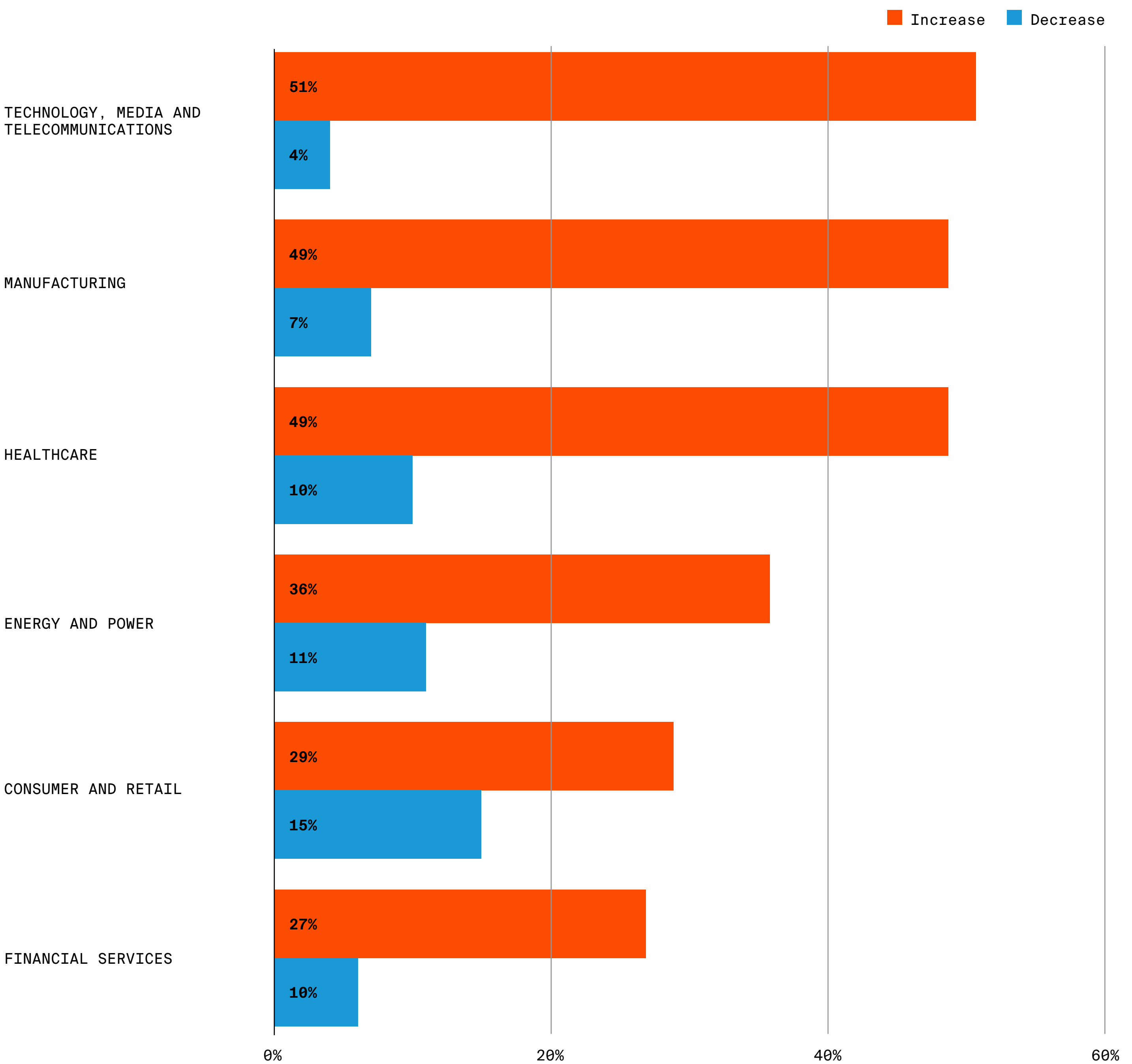


2022 Volume by Industry Sector

When asked to predict the pace of deals in specific industries, merger advisors say that there's most likely to be an increase in acquisitions of technology, media, and telecom companies. Interestingly, the perennially out-of-favor manufacturing sector was overwhelmingly predicted to have more deals in 2020, as was healthcare.

Three industries were seen as more likely to keep a steady deal pace than to increase or decrease in volume: energy and power; consumer and retail; and financial services.

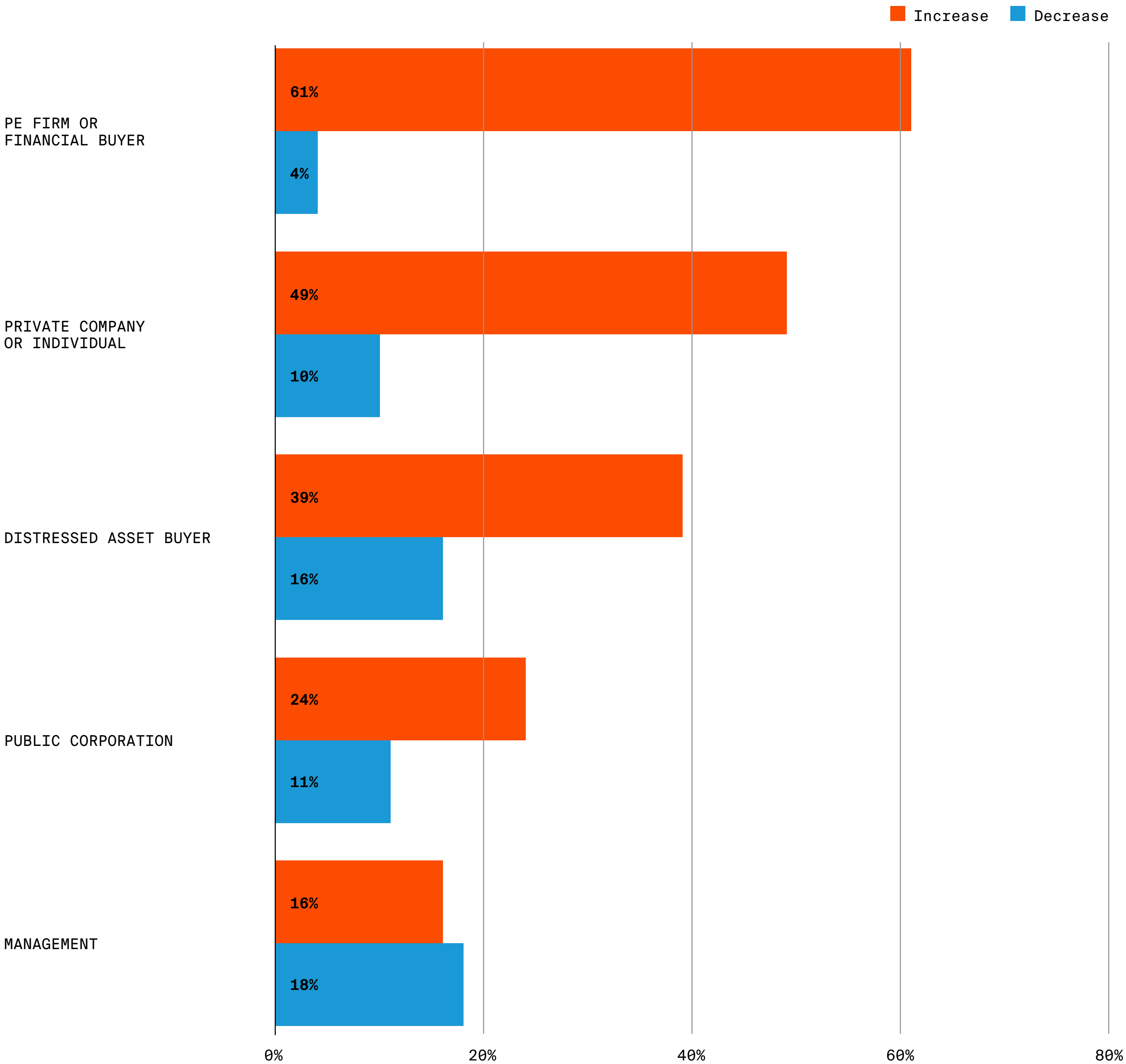
In 2022, do you expect the volume of deals your firm handles in the following industries to increase, decrease, or stay the same?



2022 Buyer Interest

Perhaps the underlying reason why the advisors expect so much growth is that they keep seeing more buyers pouring into the market. Six out of ten expect another increase in 2022 in private equity firms and other financial buyers. The only category of buyers that is seen as more likely to decrease than increase is company management.

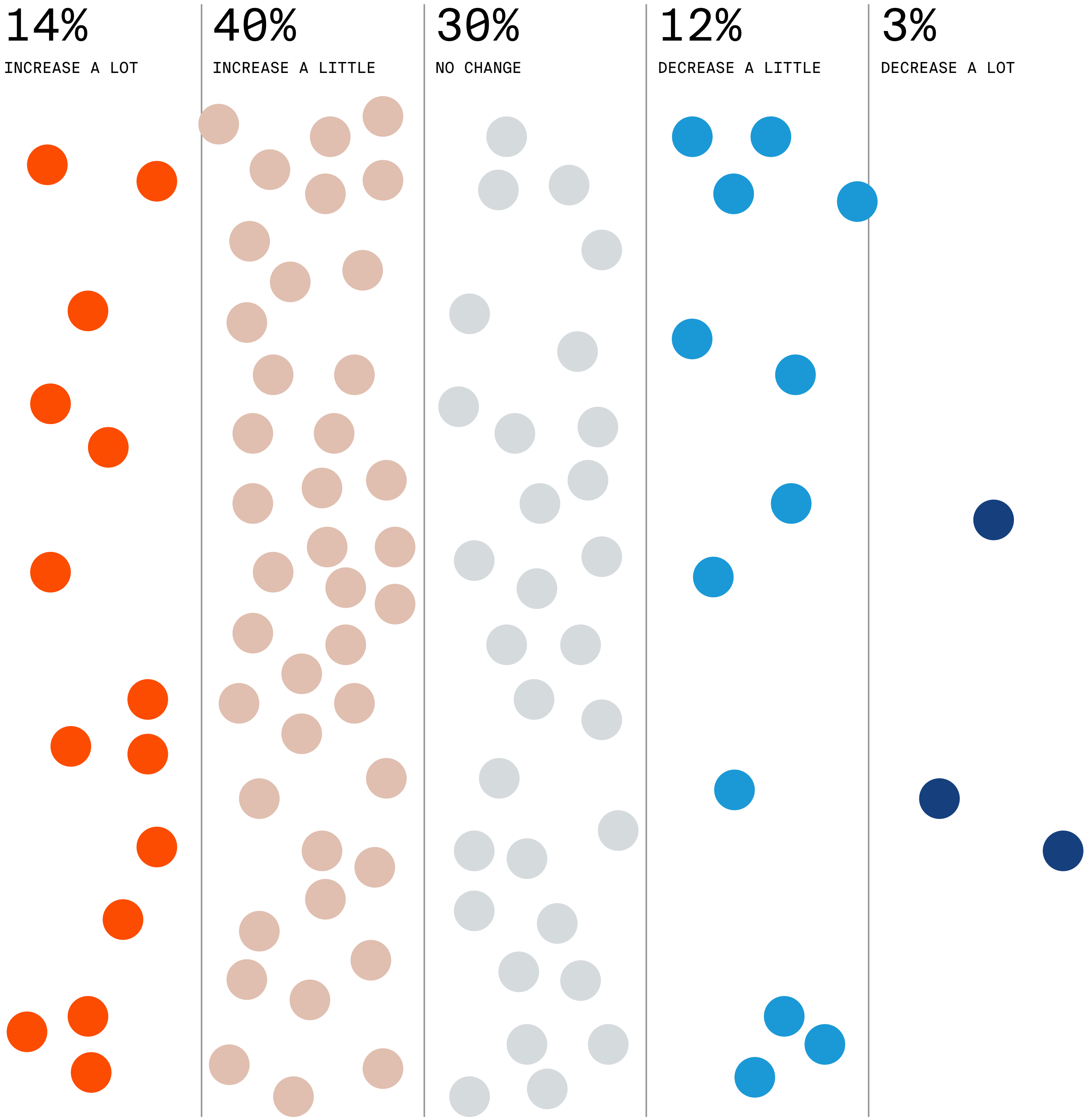
Among the deals your firm handles, do you expect the following types of buyers to increase, decrease, or stay the same in 2022?



2022 Seller Interest

With lots of buyers paying ever-higher prices, more business owners have been eager to cash in. More than half the advisors predict that even more companies will put themselves on the block in 2022 than in 2021. Only 15% see a decrease in sellers.

How do you expect to see the number of active sellers on the market change in 2022 compared to 2021?



Advisor Success Rates

With so much business, one of the biggest challenges for many advisors is allocating their time to deals most likely to pan out. We asked a series of questions about their success rates – the percentage of deals they start that are completed.

Most commonly, the advisors closed about three-quarters of the deals they worked on. But 40% closed less than half while a lucky 14% completed at least nine of every ten deals they started.

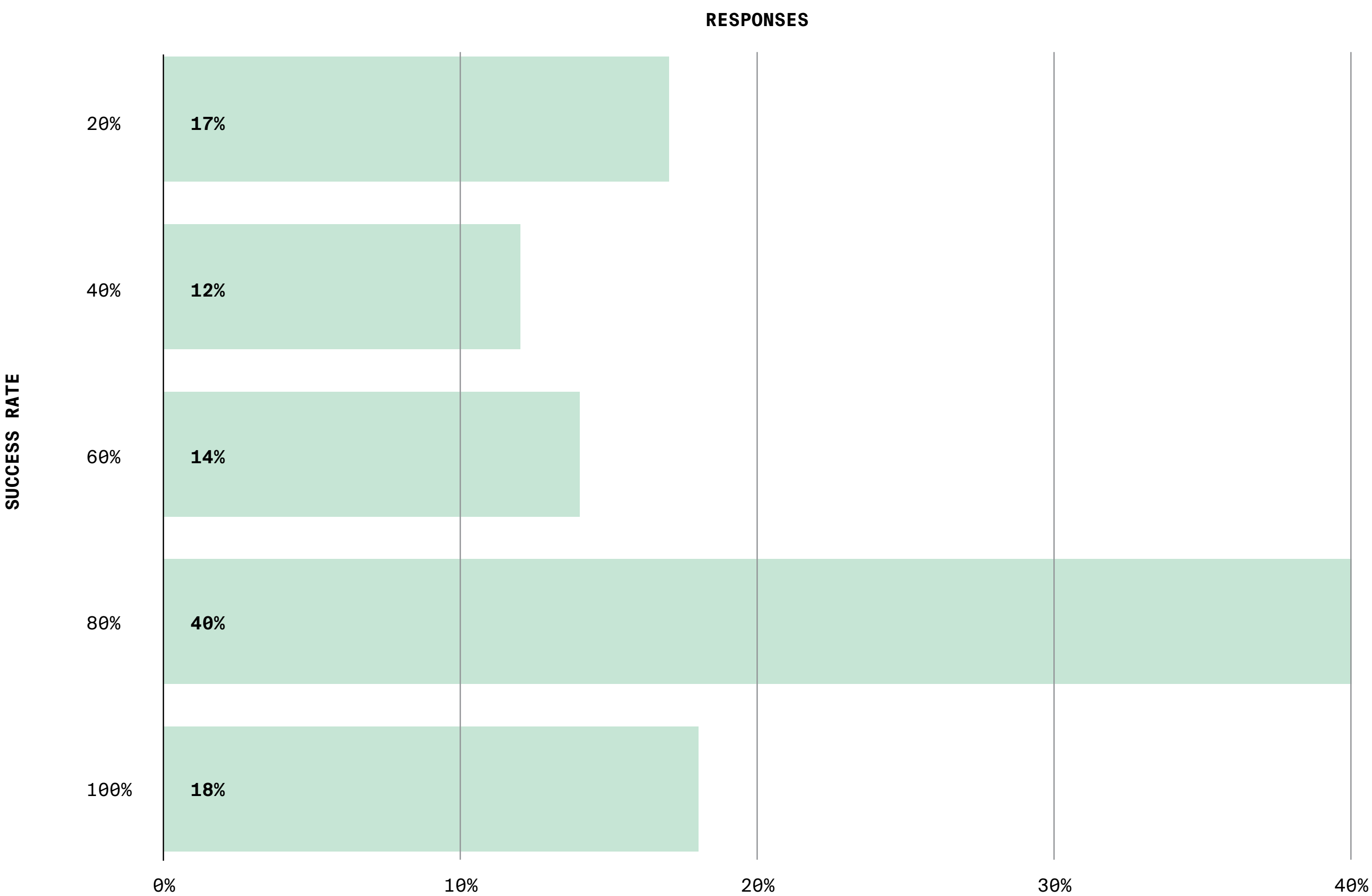
Given all the crosscurrents in the market, perhaps it's understandable that there was no clear trend in success rates compared to prior years.

Advisors who said their success rate had increased reported they completed an average of 80% of their deals. Those with declining success completed 37%. The average, for those having an average year, was 59%.

And when asked to predict their success rate in the coming year, the advisors were as confident here as on the rest of the survey. More than half said they expected to close a greater portion of their deals in 2022 than they did in 2021. Only 10% predict less success.

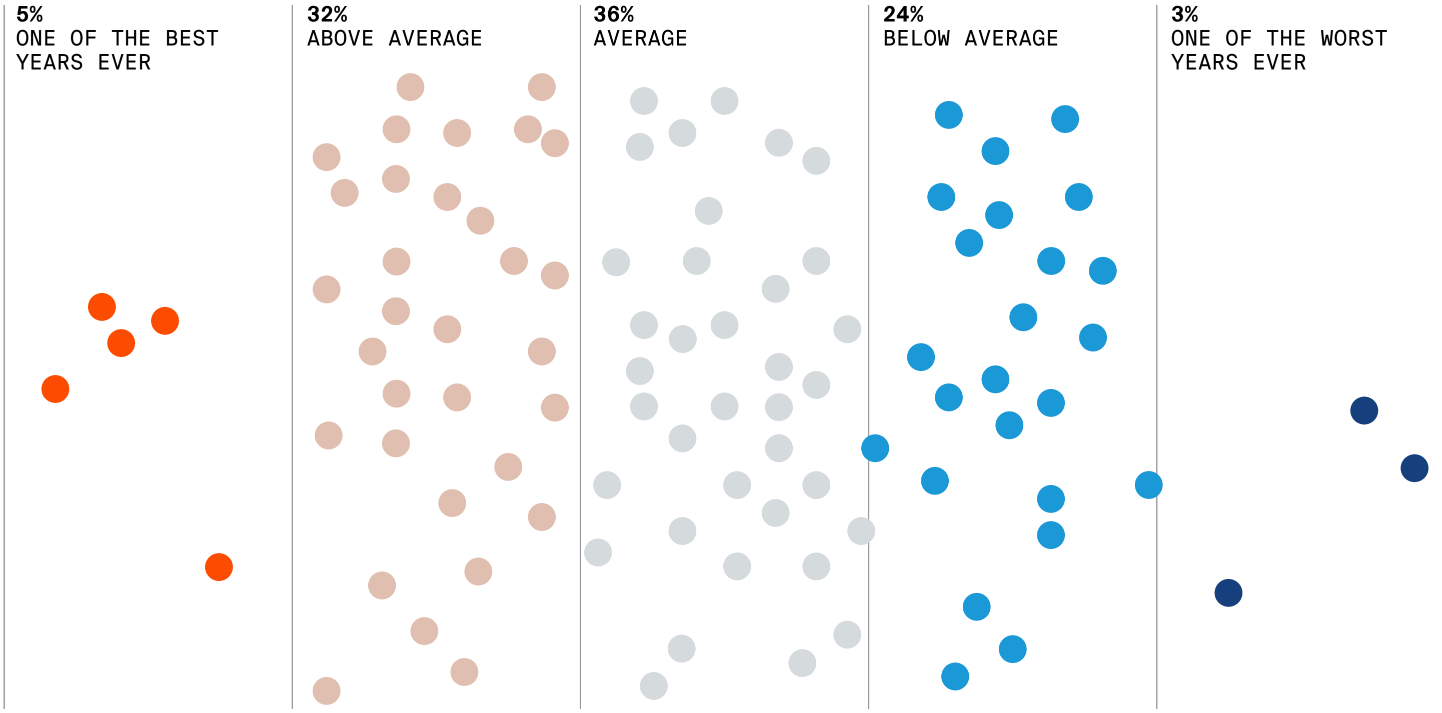
"Our firm is more selective on new client engagements, going upmarket for higher quality deals," said Aaron Solganick of Solganick & Co., which has been increasing its success rate. **"We are requiring clients to get sell-side quality of earnings reports prior to going out to market, which helps increase the confidence in sellers' financials and helps us to close more deals."**

As a percentage, what do you estimate your firm's success rate (deals started vs completed) was in 2021?

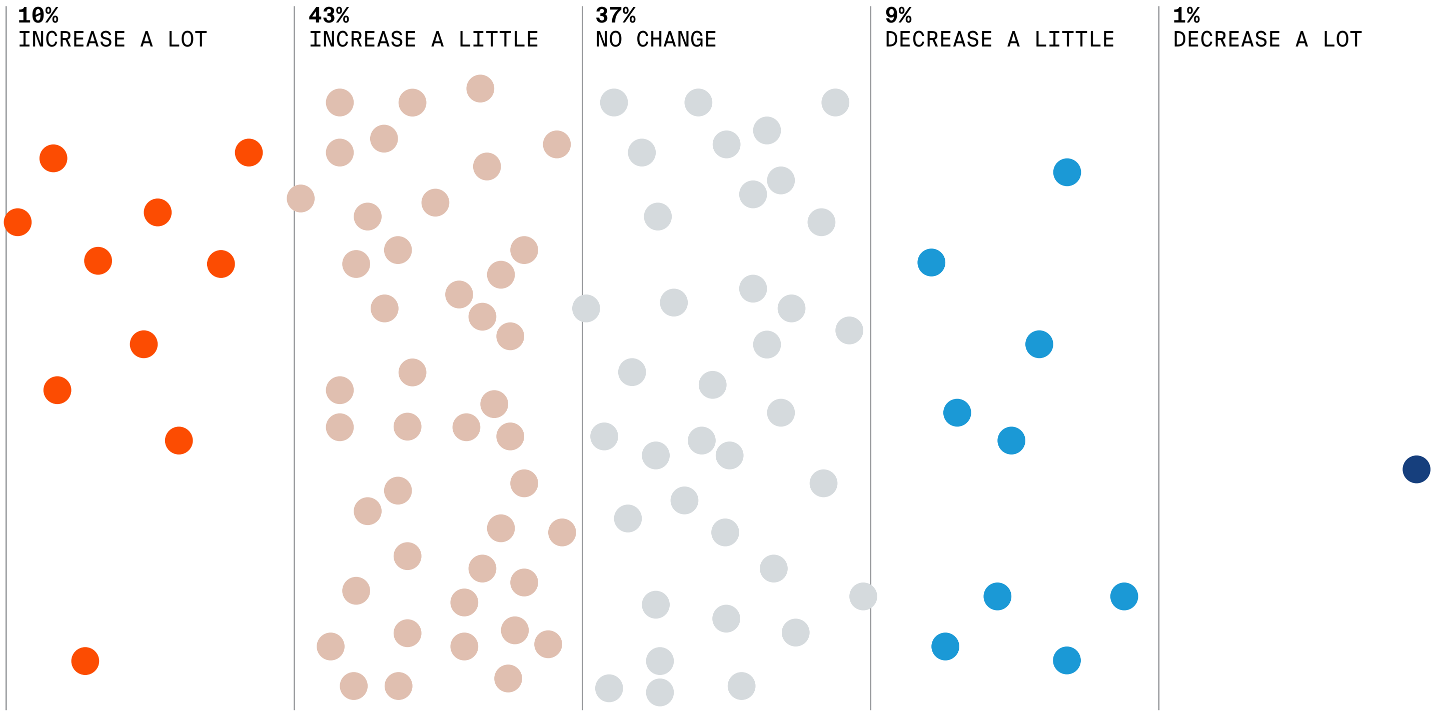


Advisor Success Rates *CONITINUED*

How does your estimated success rate for 2021 compare to a typical year?



How do you expect your firm's success rate in 2022 to compare to 2021's rate?



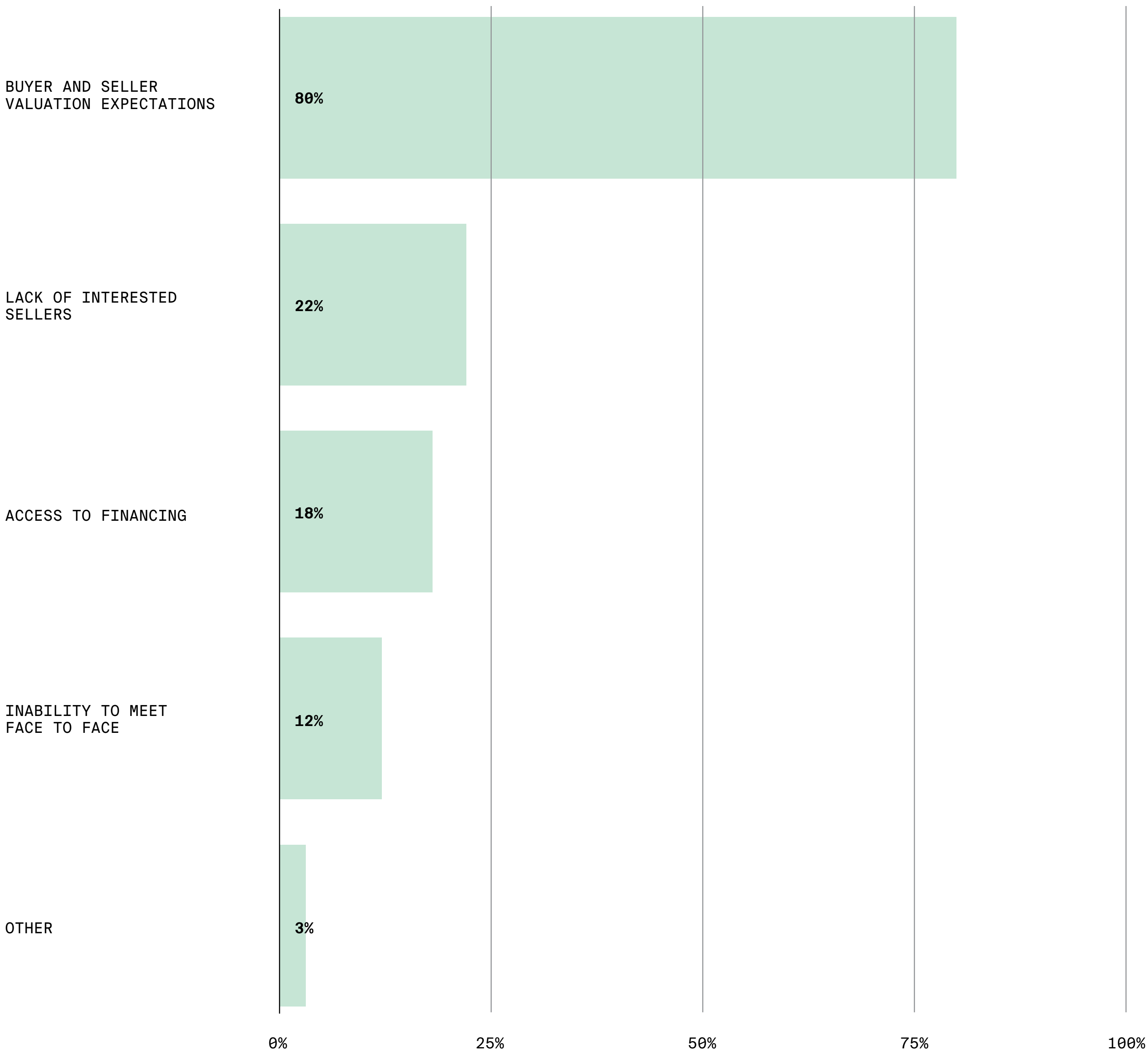
Challenges in 2022

In 2022, the advisors see more deals at higher valuations and a greater success rate. They still see that they will have some negotiating work to do. Four out of five of them said their biggest challenge would be bridging the value expectations of buyers and sellers.

"Seller expectations are too high at present," said Colin Marson, the managing partner of Lisergy Consulting in Lutterworth, United Kingdom.

Other potential pitfalls — including a lack of sellers, scarce financing, and continued lockdowns — concerned a small sliver of the advisors.

What do you see as the biggest challenge for completing deals in 2022? (Select all that apply.)



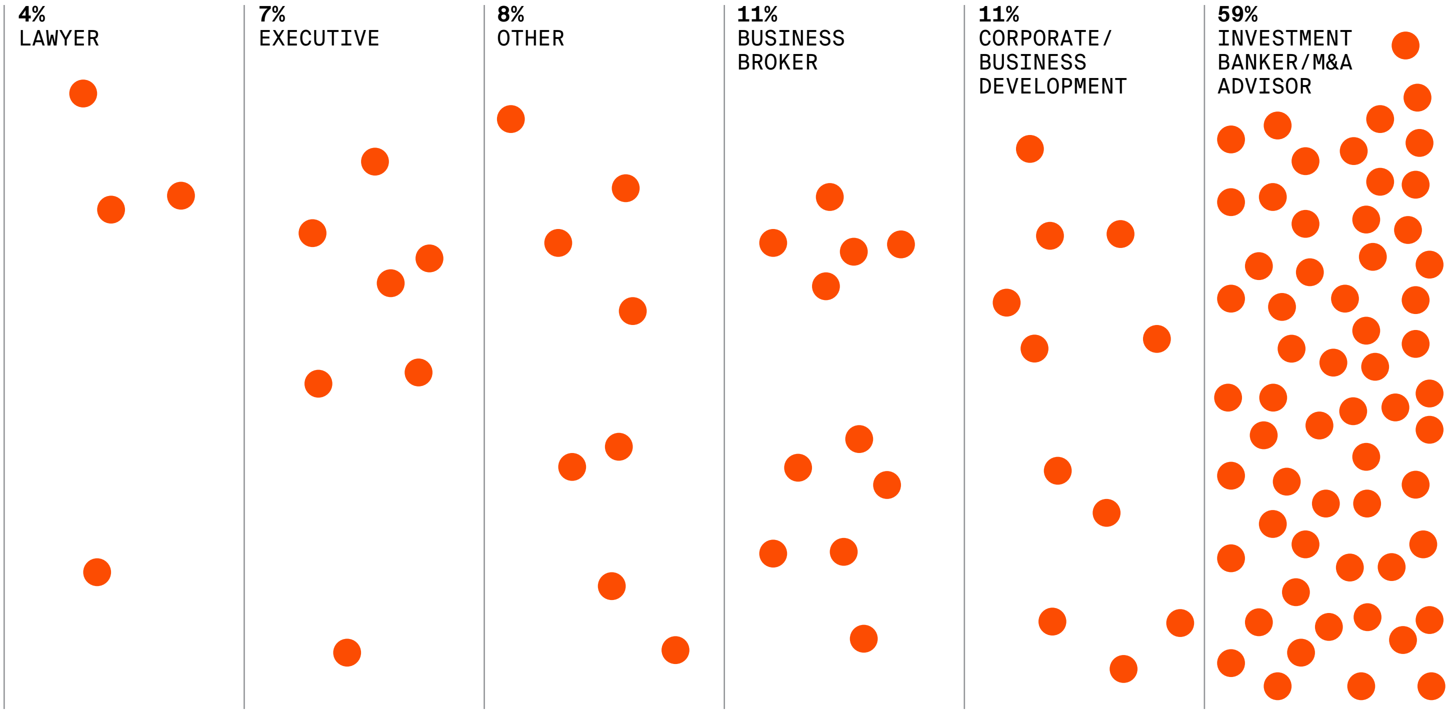
Conclusions

In 2021, the coronavirus pandemic became a catalyst for a significant consolidation among mid-size businesses. In the face of periodic shutdowns, supply chain disruptions, and labor shortages, entrepreneurs all see that scale is essential for survival. Some choose to meet the challenge through acquisitions, as others seize the moment for an exit.

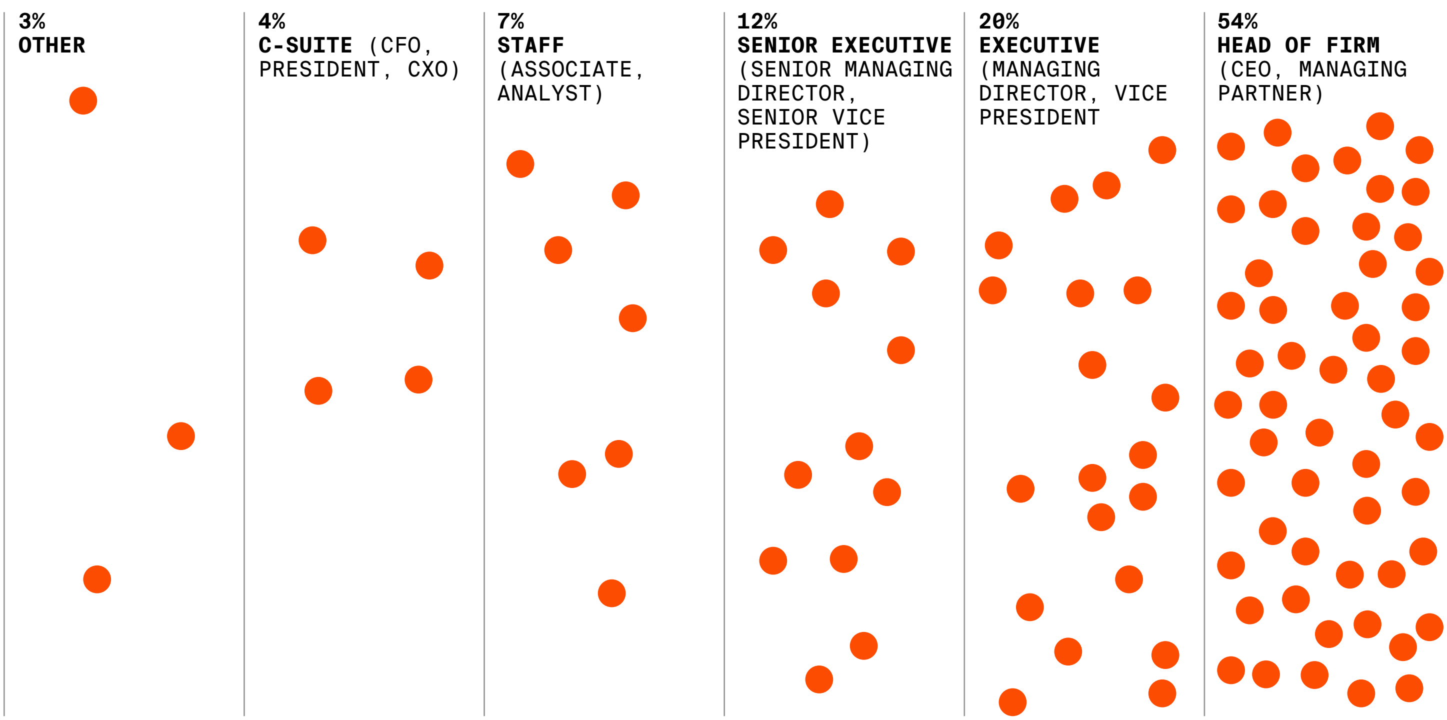
Heading into 2022, many potential disruptions are on the horizon. The Omicron variant has spread rapidly through the world. Central banks are talking about raising interest rates. And each new high of public and private market equity values raises new questions about a potential correction. Yet on balance, merger advisors are confident that the fundamental forces that have been driving the M&A market will continue to keep them busy into the new year.

Appendix : Respondent Demographics

Which of the following best describes your current occupation?

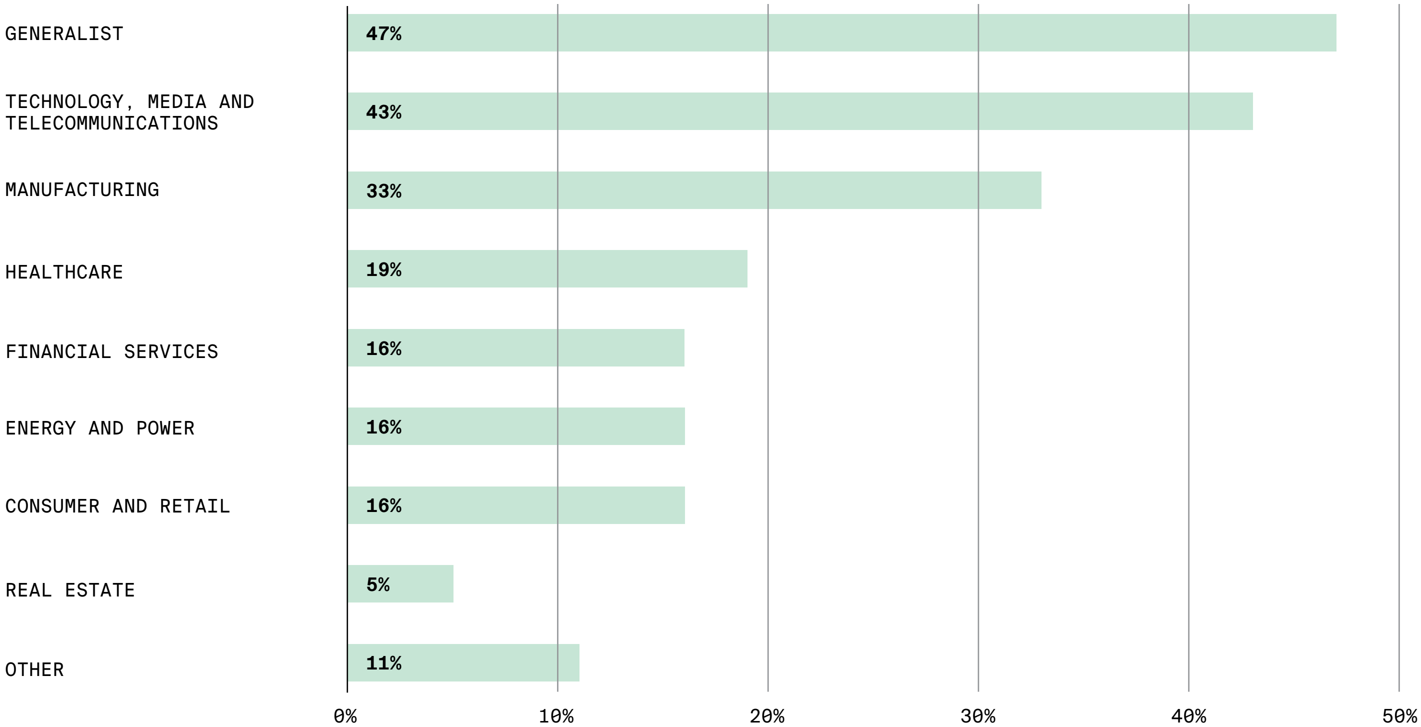


Which of the following best describes your job title?

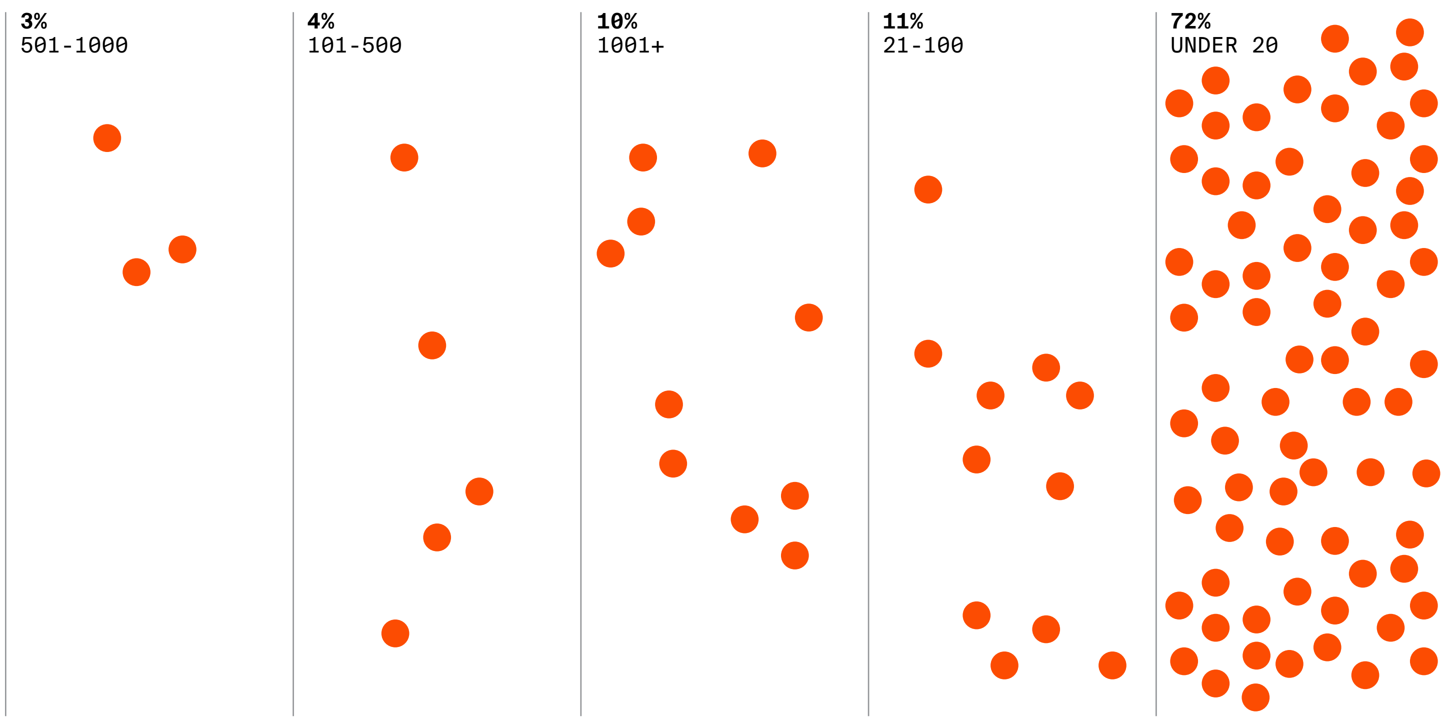


Appendix : Respondent Demographics *CONITINUED*

Do you specialize in any of the following industries? (Select all that apply.)

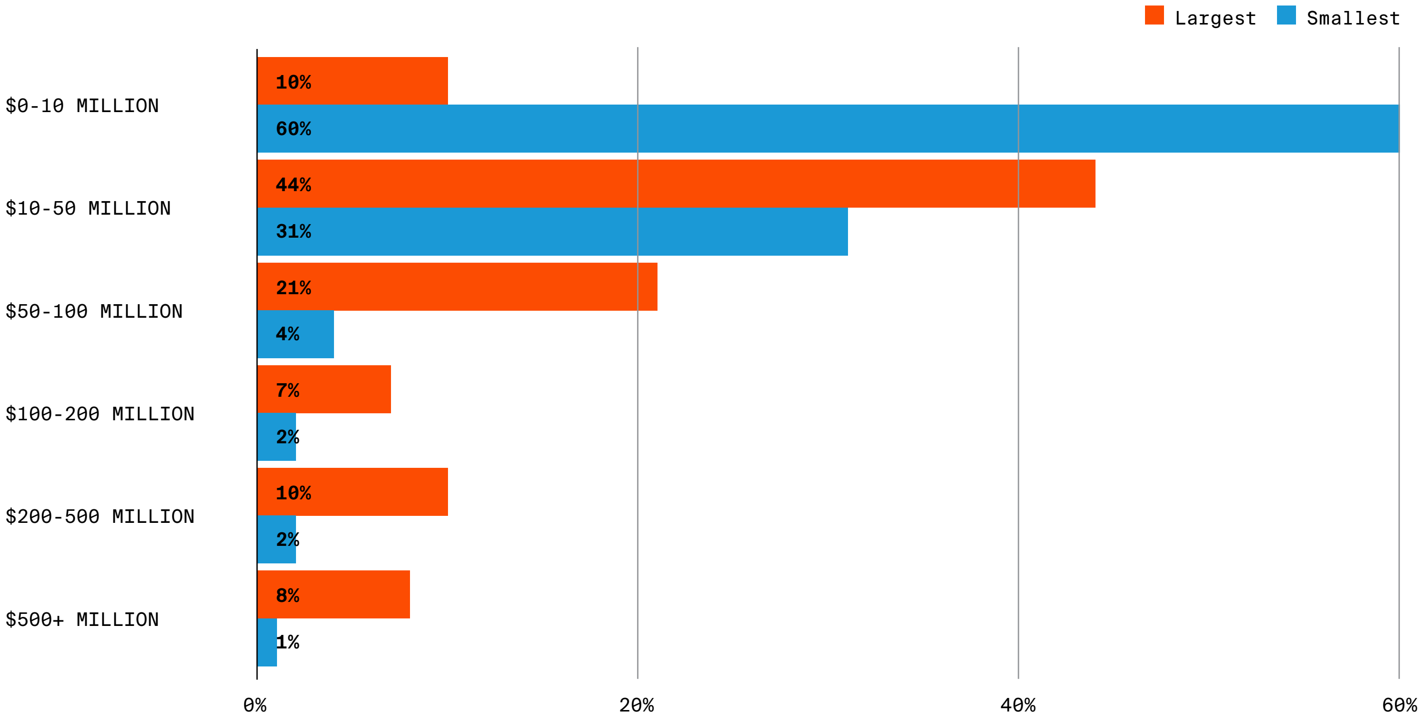


How many total employees does your firm have?

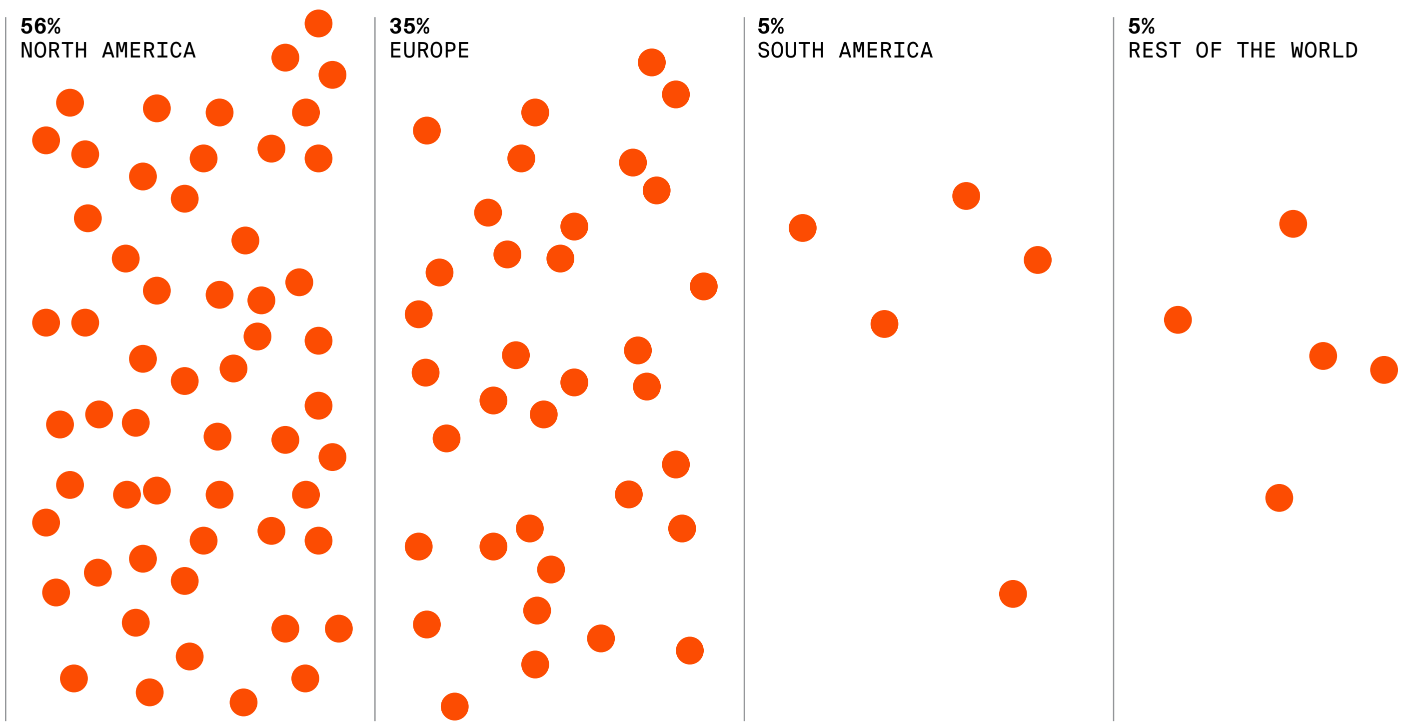


Appendix : Respondent Demographics *CONITINUED*

What is the smallest/largest deal value typically worked on by your firm?



What region do you primarily work in?



About Firmex

As one of the world's most widely used virtual data room providers, Firmex supports complex processes for organizations of all sizes, including diligence, compliance, and litigation. Whenever professionals need to share sensitive documents beyond the firewall, Firmex is their trusted partner.

A Firmex subscription provides simple, safe, and stress-free document sharing without hidden costs or complexity. Since 2006, Firmex has helped over 140,000 companies worldwide take control of their confidential documents.

For more information, please visit firmex.com.

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