FIRMEX

Deal Flow Bulletin

Q2 2022

Partnered with:

divestopedia DealCircle

Bulletin Highlights

- In **North America,** the pace of announced **deals will be up 11% from last quarter,** according to a Firmex analysis of virtual deal room formation. From the same period a year earlier, deals will be down 6%.
- In **Europe, deals will increase by 19% from the previous quarter,** and 1% from a year earlier.
- Merger advisors remain both busy and optimistic. Half say that deal volume is increasing.
- The invasion of Ukraine is disrupting some business, with **40% of advisors in Europe saying the war is depressing dealmaking.**
- Valuations continue to be at record highs, but a growing minority of advisors think they are heading down in the next three months.
- Cross-border transactions are also increasing, with nearly half of the advisors seeing more foreign acquisitions of companies in their home countries.
- The market is getting bigger. **There are more companies for sale and more potential acquirers.**
- Private equity firms are increasingly on both sides of the table, actively buying companies and selling earlier acquisitions.
- **Special Purpose Acquisition Corporations (SPACs) are declining as a force in the market.**
- Overall, two-thirds of merger advisors say they feel positively toward the market, and only 11% feel negative. That's a bit less optimistic than they were in the second half of 2021, but about the same as a year ago.

Contents

Introduction

We're pleased to bring you this quarter's global deal flow report in partnership with John Carvlaho of Divestopedia and Kai Hesselmann of DealCircle. Their networks and expertise helped us better understand the status of the middle market amongst shifting uncertainties. While a variety of stressors to deal-making persist, the report indicates that advisors remain positive about the market. In fact, survey results suggest that the market is growing, with advisors seeing an increase in companies for sale and an addition of new potential acquirers, signaling another busy quarter for dealmakers. Our look at valuations, volume by sector, buyer and seller interest, and more, will prove useful for those looking to close deals this quarter and beyond.

—Mark Wright, General Manager at Firmex

M&A transactions continue to move at a breakneck pace across most industry sectors and regions. I believe the increased deal volumes have been driven by several factors. These would include 1) Continued access to capital at relatively low interest rates. The fear of increasing interest rates might also be a consideration for acquirers to close deals now. 2) Pent-up demand on both the buy and sell side. Business owners that have delayed selling their companies due to Covid-19, are now testing the market again. Over the pandemic, an aging baby boomer demographic has had time to reflect on the importance of health and leisure, which has spurred motivation to find an exit, even for those that were not considering pre-Covid-19. 3) Labor and supply shortages have forced growing companies to look at acquisitions to fulfill operational capacity constraints.
4) Risk and future uncertainty in the geopolitical landscape has many M&A participants (buyers and sellers) taking advantage of the opportunity to transact now, while the M&A environment is still somewhat predictable.

These factors have contributed to the perfect storm for M&A deals. Increasing interest rates, normalization of supply chain issues and geopolitical risks pose significant challenges that can derail the currently robust M&A environment.

—John Carvalho, Founder of Divestopedia and President of Stone Oak Capital

In recent months, some dark clouds have appeared in the M&A sky. The war in Ukraine, with it the sharply rising energy costs, inflation and of course interest rates, are depressing the mood. All not good omens for further growth in the M&A market. But is that really the case? 2021 was already a record year, and the Corona pandemic, which still exists, had little effect on it. The Q2 2022 Dealflow Bulletin from Firmex gives reason for hope, as the top dealmakers expect no or only few negative implications. On the contrary, even for 2022, further growth and rising valuations are expected. The only question that remains is how long the M&A market can decouple itself from the macro perspective. So far, at least, it looks very good.

—Kai Hesselmann, Co-Founder and Managing Partner of DealCircle

Overview

In the three months since our first quarter Deal Flow Bulletin, the geopolitical order has been shaken by the biggest ground war in Europe in 70 years. Beyond the tragic human toll, Russia's invasion of Ukraine has set off a cascade of economic aftershocks. Prices have surged for energy and grain as sanctions disrupt global trade.

The war adds to the turmoil spawned by the Covid pandemic, with tight labor markets, backlogged supply chains, inflation and rising interest rates.

To be sure, most broad economic indicators are healthy. Unemployment is low, and public markets remain at lofty valuations. The outlook, however, is decidedly uncertain.

For merger advisors working with small and midsized companies, one thing at least is certain: the looming doubts about the future are encouraging both buyers and sellers to do deals now.

That's the clear conclusion when we look at the brisk pace of deal rooms formation on the Firmex platform in early 2022, an indicator of transactions to be announced in the second quarter of 2022. And it's reinforced by our survey of global merger advisors.

Whatever the turmoil, observes Christopher Anderson, a managing director with EMA Partners in Denver, "life still goes forward. People still retire. And the amount of capital still unused will keep activity strong."

Observations

Deal volume is affected by existing market momentum and potential concerns around the corner. Many sellers who missed the boat in 2021 are jumping into the market this year to take advantage of the continued strength of M&A momentum, low interest rates and favorable lending environment, and high volumes of dry powder. Potential long-term concerns surrounding geopolitical instability, rising inflation, proposed Fed hikes, and the upcoming mid-term elections are also forcing sellers into the market this year.

—Investment Banker, United States

Economic uncertainties are already slowing down M&A activities, especially as family business owners postpone M&A and succession planning.

—Tim Sachs, Founder of Tim Sachs Consulting, Germany

Strong financial markets and cheap access to debt still drive a lot of insanity in M&A. If markets start to wobble, who knows what is next?

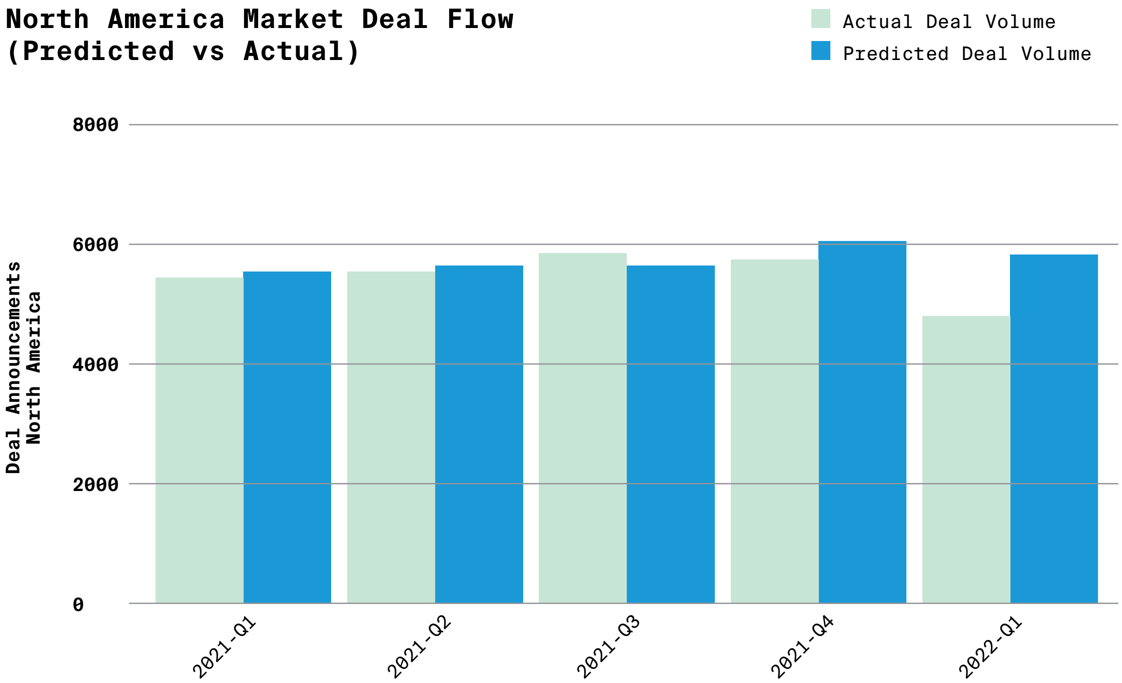
—Investment Banker, United States

There is an uptick in general. Part of this is a backlog from Covid. Mostly it's the macro environment. Retiring baby boomers, cheap money, and the need to diversify investments from overweighted traditional asset classes. The global shock of Covid is demanding a review of traditional business models and business portfolios.

—Simon Bedard, Founder and CEO at Exit Advisory Group, Australia

About the Deal Projections

The forecasts of second-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 20,000 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.



About the Survey

The insights about market dynamics are drawn from an online survey in March and April 2022 of 167 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 five or fewer employees that typically handles deals between $6 million and $50 million, mostly for sellers.

The most common industry specialty was technology, media, and telecommunications. Nearly half the respondents described themselves as generalists. Six out of ten were based in North America, with another three out of ten in Europe.

There was quite a diversity of respondents as well. Lawyers, business development executives, and others not directly doing deals made up 19%. Advisors at firms with more than 100 people made up 13%. And 24% regularly handle deals valued at $100 million and up. See the appendix for detailed information on respondents.

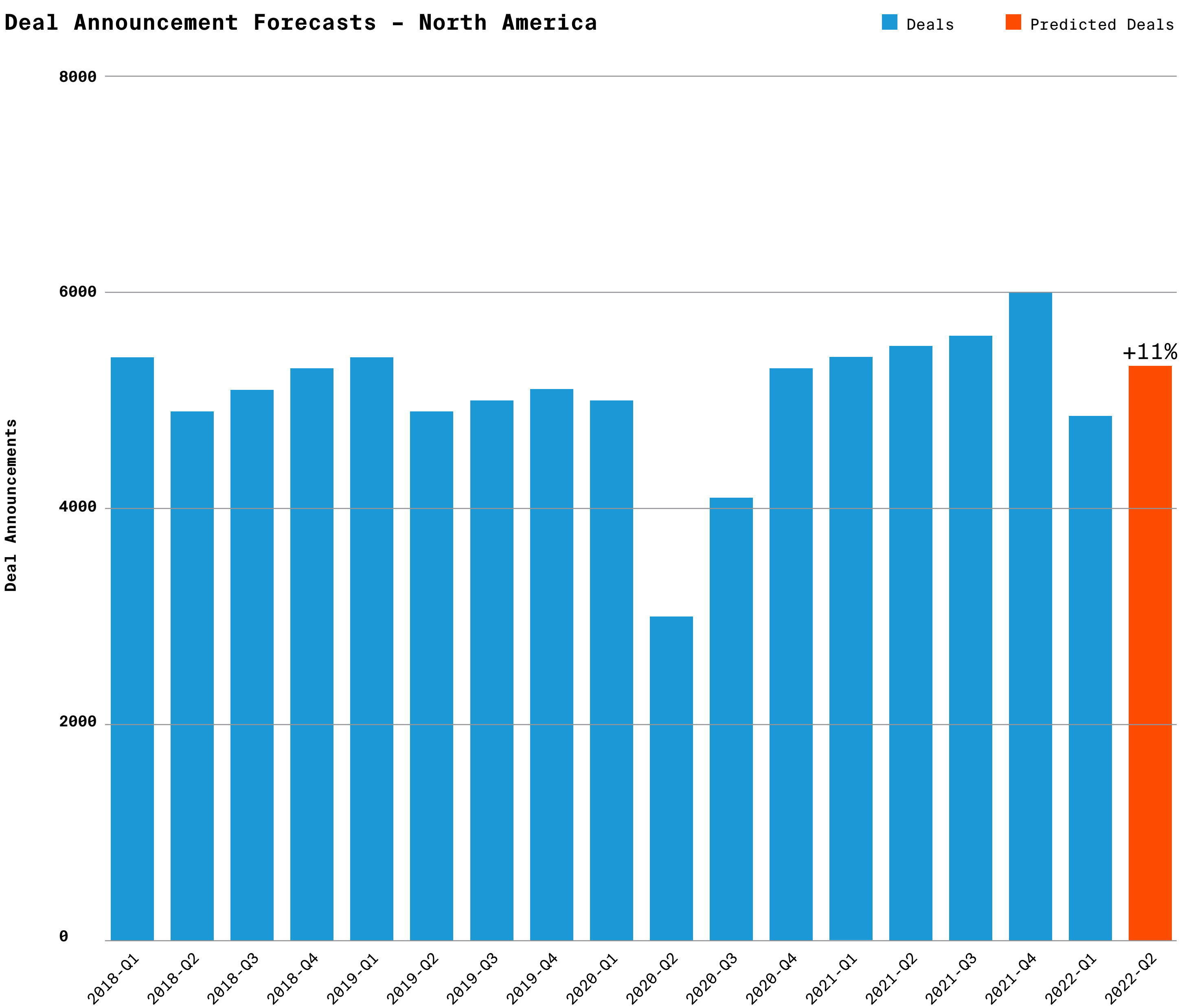
Firmex has conducted quarterly surveys with similar methodologies since 2021.

The Firmex Deal Flow Forecast:
North America

Dealmaking in North America is slower this year than last year, but the decline will be smaller in the second quarter of this year than in the first quarter.

Firmex projects the number of deal announcements in the second quarter of 2022 will decline by 6% from the same period in 2021.

That represents a slightly better performance than the first quarter of 2022 when deal announcements fell by 13% from the prior year. In fact, deals in the second quarter of 2022 are projected to be 11% higher than in the first quarter of this year.

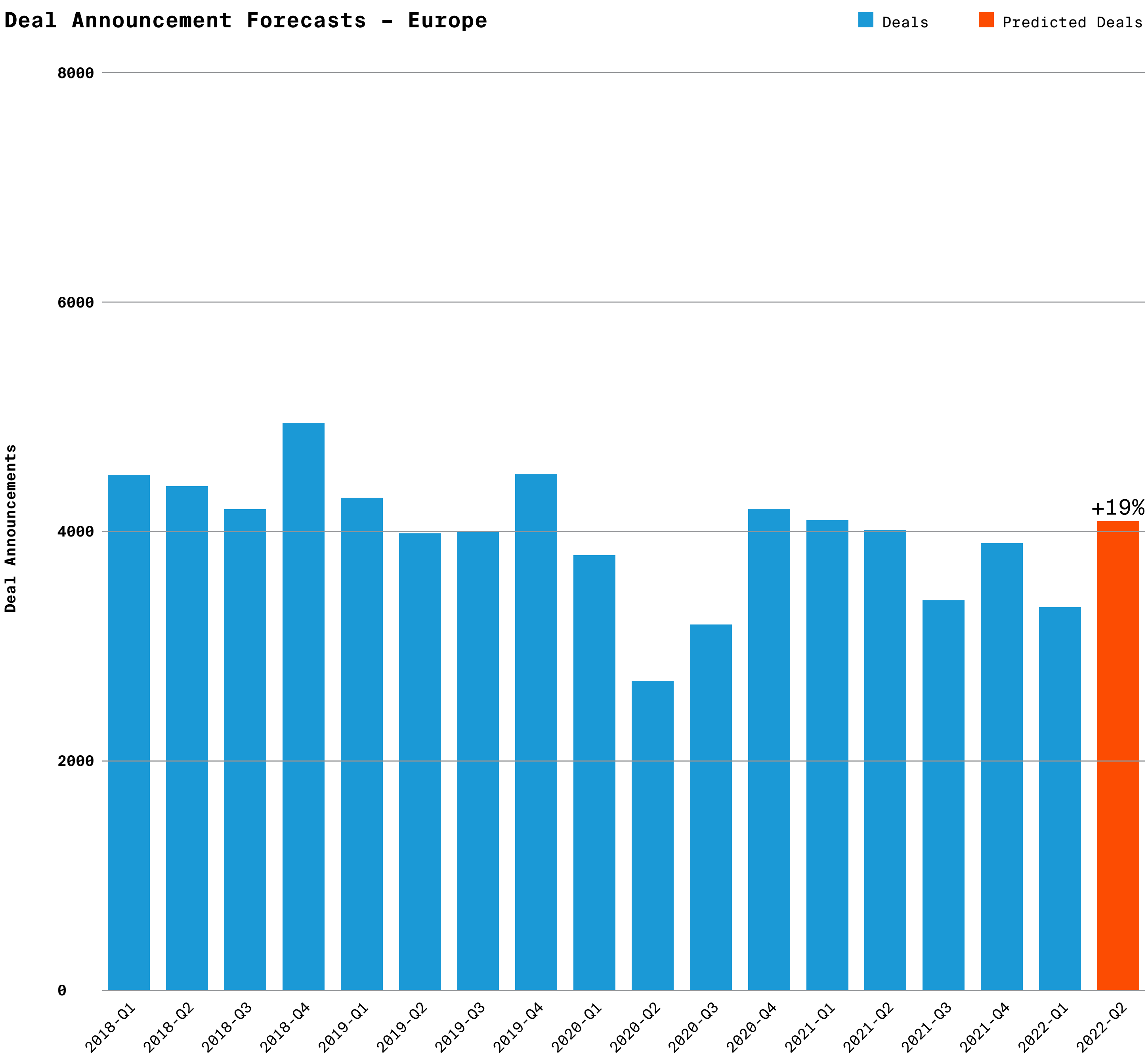


Source: S&P Capital IQ (2018 - 2022 Q1), Firmex analysis Q2 2022

The Firmex Deal Flow Forecast: Europe

Despite the outbreak of war in Ukraine, dealmaking in Europe is on track to grow in the second quarter. Firmex projects that deal announcements will increase by 1% in the second quarter of 2022 from the same period in 2021. Announcements will be 19% higher in the second quarter of this year than in the first quarter of 2022.

The growth in deal announcements in Europe contrasts with the slowdown in North America. One explanation for the difference may be that Europe did not experience the same frenzy of dealmaking last year that hit North America, where announcements increased by 71% from 2020 to 2021. In Europe, the increase in 2021 was only 40%.



Source: S&P Capital IQ (2018 - 2022 Q1), Firmex analysis Q2 2022

Impact of the Ukraine Conflict

Russia's invasion of Ukraine, which began about a month before the survey was conducted, was not interfering with business for most of the advisors surveyed. More than half said they did not expect the conflict to change deal volume over the next three months.

Overall, 21% said that the conflict would decrease deal volume. Those in Europe, not surprisingly, were more affected, with 40% expecting volume to fall.

"Nervous shuffling, worry, and caution," was how one investment fund executive in the United States put it.

"In Poland, there are very high interest rates as a result of Covid, inflation, war, etc., A number of deals have already stopped as a result," said a Polish financial advisor. **"Across the CEE region, buyers in some industries, like logistics, will want to keep transactions on hold or withdraw from planned transactions due to uncertainty over the economic situation."**

Only 4% of Europeans expect the conflict to increase dealmaking, while 9% of North Americans do.

"Fear motivates business owners to act whether buying or selling," explained one advisor in the United States.

"Sellers are coming out of the woodwork. People are scared," added Mark Borkowski, president of Mercantile Mergers and Acquisitions in Canad.

Vito Bugini, a partner at Equity Factor in Italy, foresees disruption in Europe ultimately increasing cross-border acquisitions.

"In the EU, the increase in commodities prices will add to the already growing inflation. The USD will be strengthened. Inbound M&A to the EU will increase as many cheap opportunities will be introduced to US acquirers," he said.

And of course, those far from the conflict benefit as capital flows away from risk. **"We expect more investment to be directed to Latin America,"** said Brazilian banker Marcelo Vieira da Silva.

Yet distance may not be enough to shield the market if the conflict accelerates. **"If it goes on long enough or escalates further, it could have a material impact on sentiment globally,"** said Simon Bedard, Founder and CEO of Exit Advisory Group in Australia. **"Then it will trickle down to our patch."**

Observations

I do expect temporal deferral on active deals in the short term. In the long run, the M&A market will decline in case the current sanctions should be maintained.
—Investment Banker, Germany

War brings uncertainty over how the World and the European economy will be affected. The magnitude of the impact on inflation, consumption, etc., is not clear yet. Also, the availability of bank financing for M&A transactions is uncertain. ***—Investment Banker, Hungary***

For oil and gas, the price volatility and record high prices are expected to drive the buyer-seller gap and reduce asset-level deals. Some larger mergers may occur.
—Laura Freeman, Managing Director of Business Development & Engineering at Highpoint Global Capital, United States

Increased uncertainty around interest rates and especially supply chain increases the risk for buyers and will impact prices and terms. ***—Tom Schmidt, Managing Director at Norton McMullen Corporate Finance Inc., Canada***

It depends on whether or not it becomes WW3 and goes nuclear. If not, then no impact.
—Greg Carpenter, Managing Partner at M&A Business

Deal Volume

The good times will continue to roll. That's the clear view of the merger advisors in the survey. Nearly half (47%) say that deal volume is increasing, while only 15% say it's decreasing.

Those in Europe are slightly less enthusiastic, with only 38% of those seeing an increase in volume compared to 51% of those in North America.

Deal volume is decreasing, said a German investment banker, because of **"customer and supplier dependencies and the overall macroeconomic situation."**

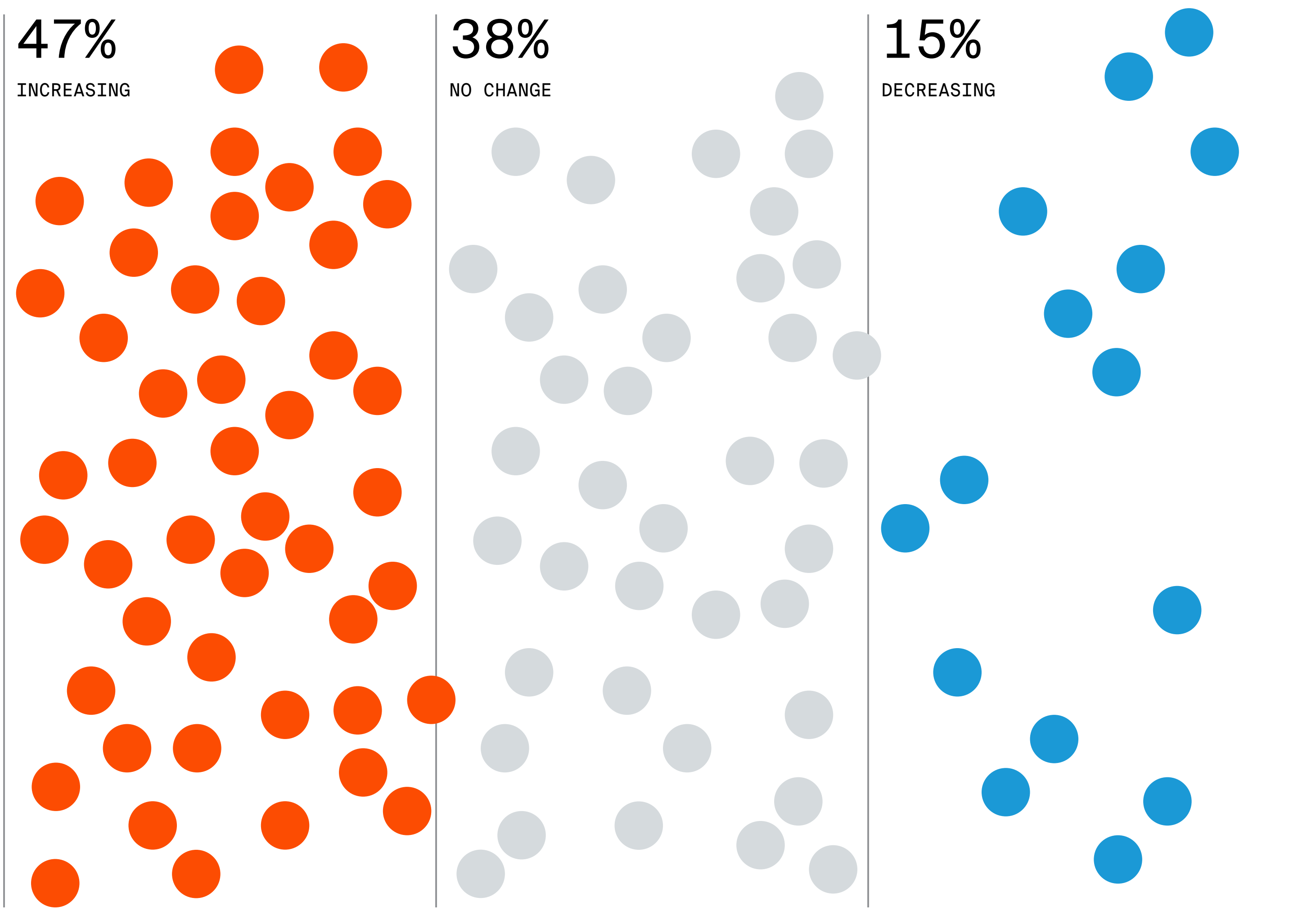
Larger firms are slightly less ebullient than smaller ones. Half (51%) of those with 50 or fewer employees expect increased deal flow compared to one-third (32%) of those with 51 or more people. Similarly, firms that primarily work on the sell side see the deal pace increasing more than those focused on the buy side.

The economic aftershocks of the Covid pandemic are influencing the deal markets in complex ways. For example, 34% of advisors see labor shortages as encouraging deals, but 27% of them say the hiring difficulities inhibit deals. Supply chain issues, by contrast, were seen as inhibiting deals by 39% of respondents and encouraging them by 31%.

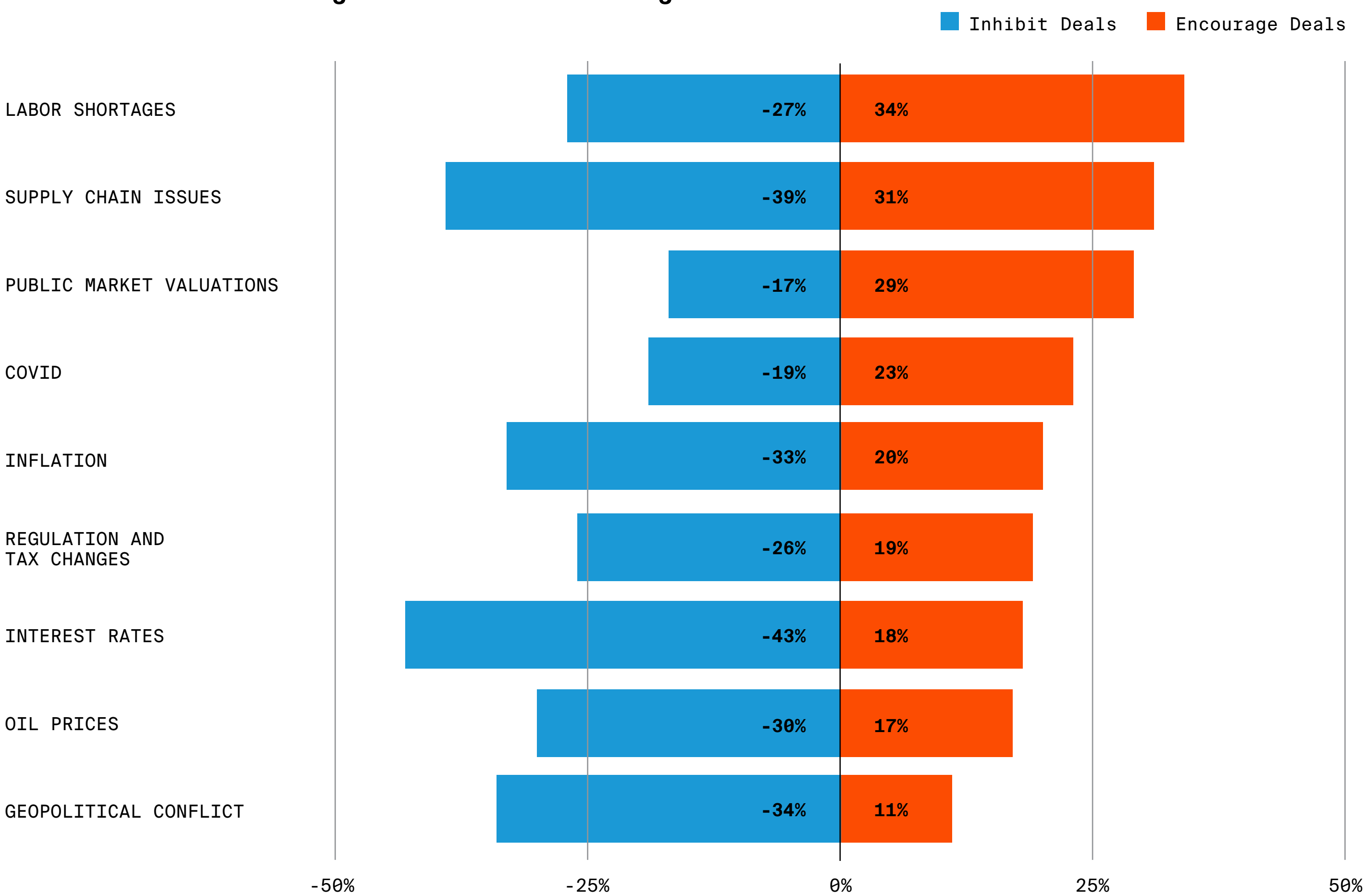
"Covid is accelerating deal volume," said a US banker. **"People are saying, 'Get me out of here.'"**

There was somewhat more of an agreement that interest rates and geopolitical conflict are bad for deals while the state of public market valuations is good for them.

How is the volume of deals in the market changing?



How are the following factors influencing deal volume?



Observations

Covid, the threat of capital gains tax increases, interest rate hikes, and record dry powder all contribute positively to seller motivation. We have been waiting for the baby boomers to come to market. They are here!!!
—David Fergusson, Managing Director of M&A at Generational Equity, United States

The race to the exits in 2021 seems to have resulted in a modest reduction of sellers in early 2022 on the industrial side, though there did not seem to be an impact on the Tech side of our business.
—Pitt Means, Founding Partner of Berntson Porter Corporate Advisory, United States

There are so many factors tugging on the deal framework—largely regardless of industry but with differing emphasis by industry—that it becomes increasingly difficult to predict even short-run conditions. Astute actors on both sides are experiencing difficulties modeling risk. ***—Investor, United States***

The reemergence of would-be sellers in a post-pandemic world, the aging of business owners, and increased M&A activity in specific sectors are all drawing in more potential sellers.
—Mark Carmichael, Managing Director at STS Capital, United States/Europe

Valuations

Companies continue to sell for record price tags. Two-thirds (64%) of the advisors say the valuations are above average. Of those, 17% say they are very high. Only 6% call current market valuations below average or very low.

The assessment of current prices is largely unchanged from our first-quarter survey. What has changed somewhat is the advisors' view of the future. Now 31% say that valuations will fall over the next three months, a larger share than the 23% who expect values to rise. In our first quarter survey, we asked for predictions for the full year. In that, more advisors expected valuations to go up (34%) than fall (24%).

The advisors that expect falling valuations typically attribute their view to the uncertain economic and political situation, including inflation, rising rates, and the conflict in Ukraine. Indeed, while advisors in North America and Europe have similar assessments of prices up to now, more European respondents see values falling (43%) than those in North America (26%).

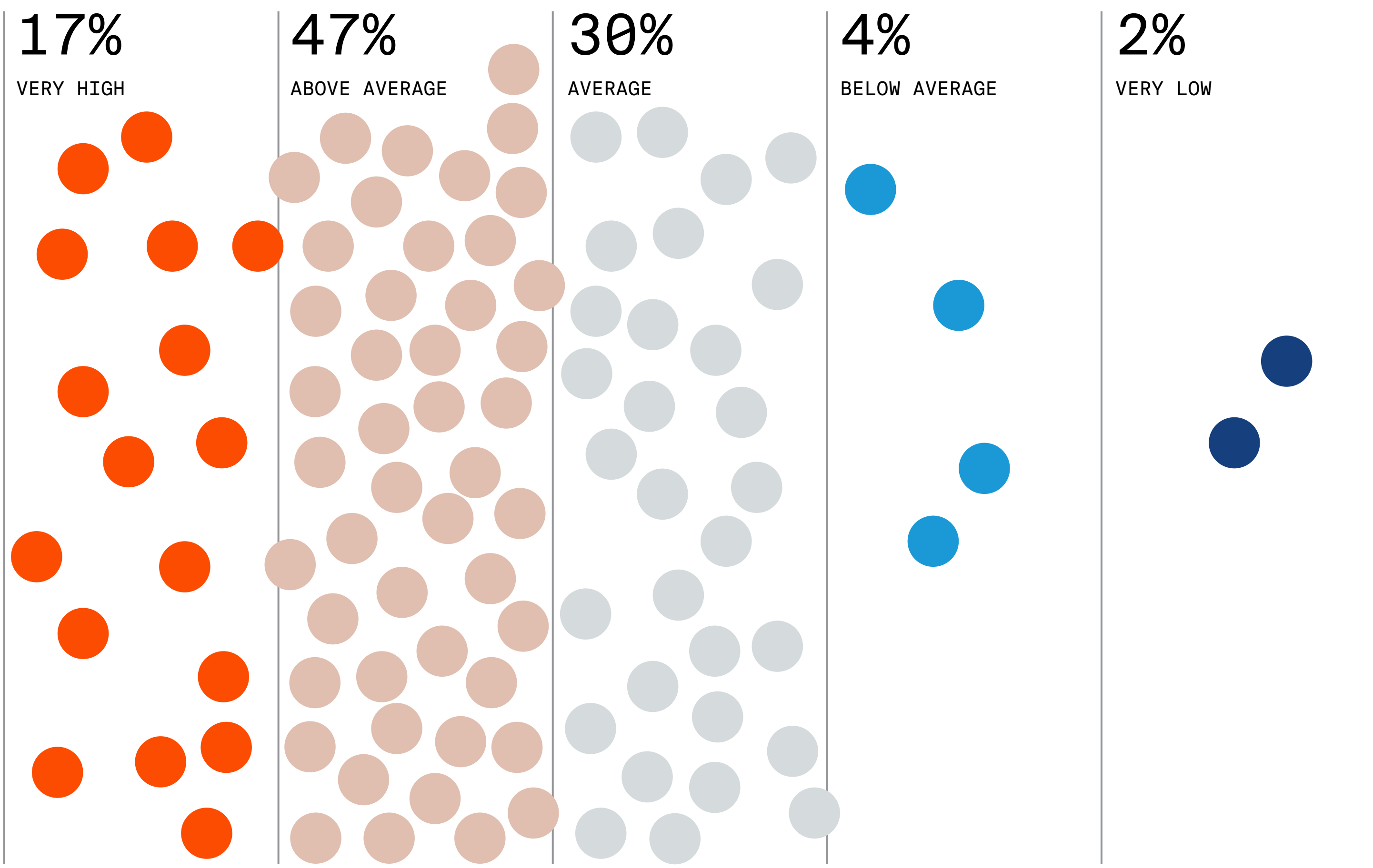
Many also cite profit pressure for sellers. **"Small and medium companies have more difficulties passing their costs through to their prices, therefore negatively impacting cash flow,"** said José Tardeli Filho, the head of Brazilian firm, Terra Boa.

Others see the natural end of a cycle. **"The market has been insanely hot for a long time. It's only natural that there will be some cooling—especially at the top-end of the market where 15x - 20x revenue multiples are not sustainable,"** said Ed Bryant, President & CEO of Sampford Advisors in Canada.

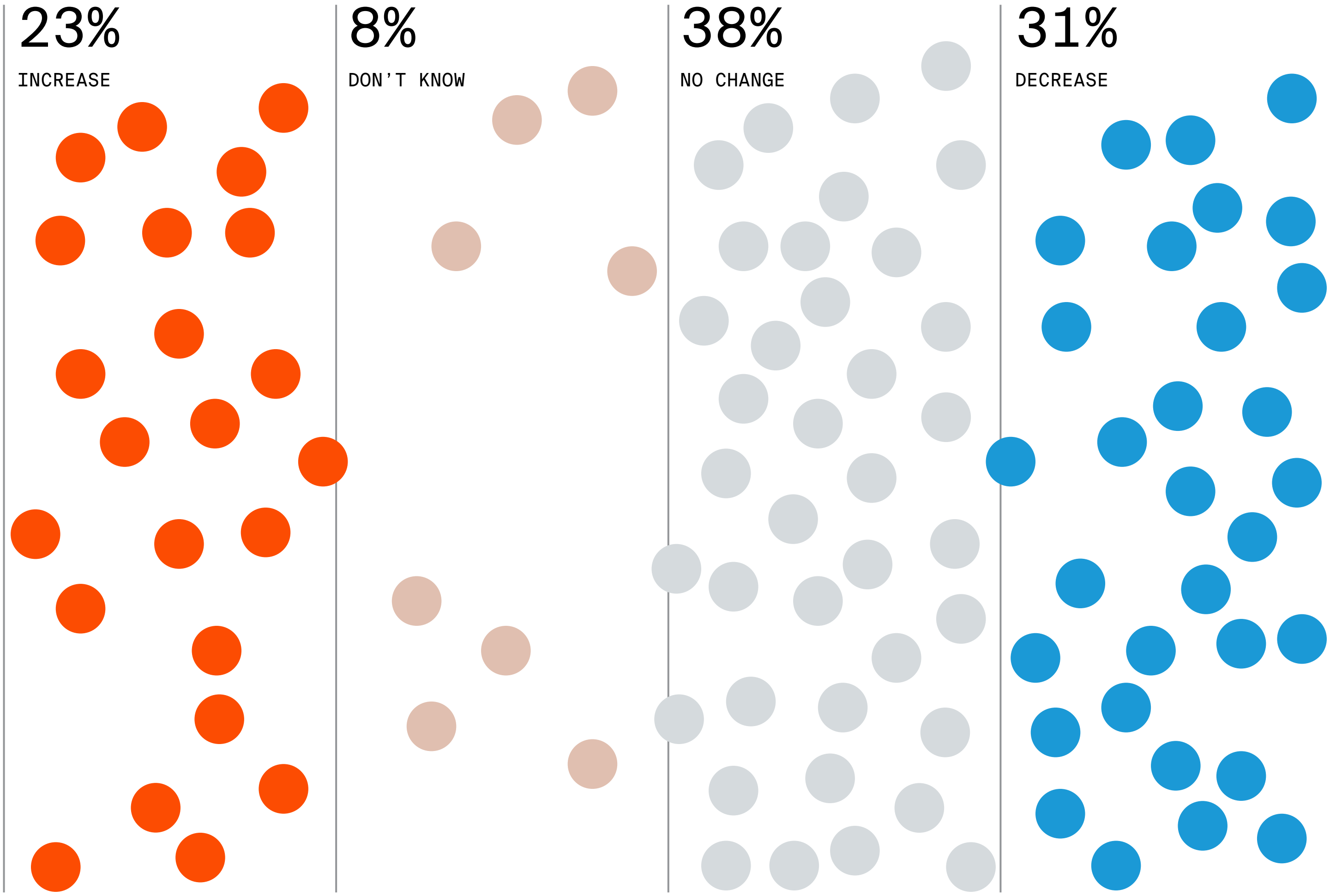
Those that see prices rising point to a shortage of sellers compared to accelerating buyer interest. Some particularly hot sectors they point to are agritech, cryptocurrencies, and medical devices.

"Because the market is recovering momentum, there is an excess of capital but a lack of projects in certain industries," said Daniel Reyes, a partner at Mexican firm Moreno Law.

Over the past three months, how would you describe the valuation of companies in deals your firm was involved in?



How do you expect company valuation to change for deals your firm is involved in over the next three months?



Observations

The appetite is great, but the inventory is limited. ***—Investment Banker, United States***

Interest rates increases, uncertainty, and inflation are all likely to decrease valuations. ***—Investment Banker, Canada***

Valuations will likely drop due to rising interest rates and political uncertainty from the Ukraine situation. ***—Peter Storment, Co-CEO of Ceder Street Capital, United States***

It is a seller's market, and interest rates are still low, so company valuations are projected to be the same in the future as they are now. ***—Tom Schmidt, Managing Director at Norton McMullen Corporate Finance Inc., Canada***

The market for value is experiencing a series of unanticipated shocks, and sentiment is increasingly bellicose and hollow sounding. A stampede is in the air but from which direction? ***—Investor, United States***

Cross Border Transactions

Nearly half (46%) of advisors say there is an increase in deals with foreign buyers acquiring companies in their home country. In Europe, 57% are seeing more inbound transactions.

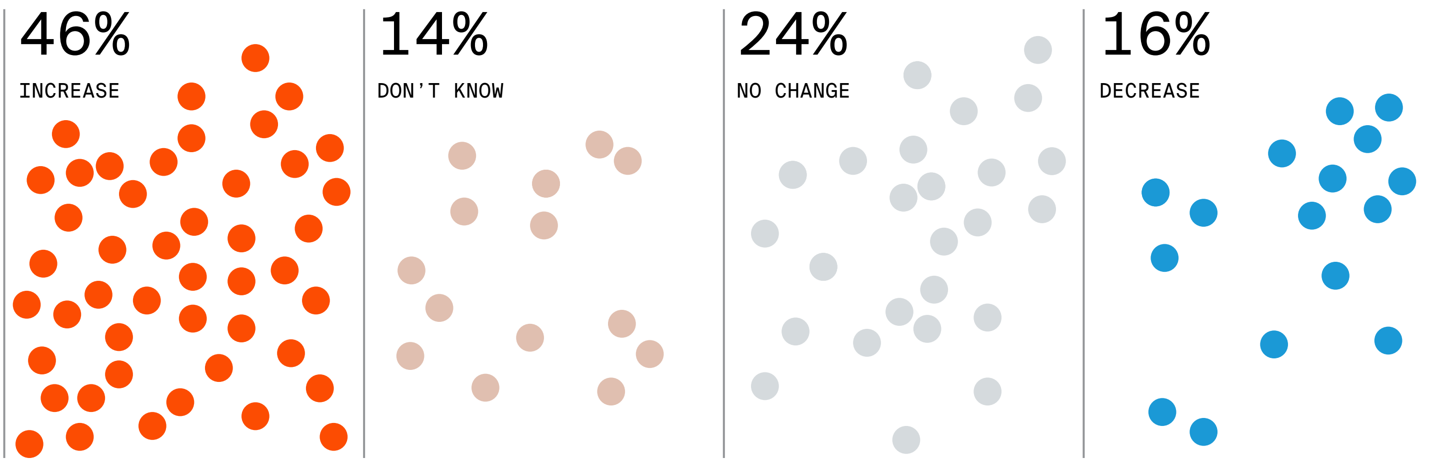
As for outbound deals, the most common view is that there is little change. Slightly more respondents see a decrease (22%) rather than an increase (15%) in companies in their home country buying a foreign firm.

Transactions involving companies in Europe are most common in the experience of the advisors. When asked to name the countries where they see the most cross-border deals, half mentioned Europe as a whole (23%) or European countries, including Britain (14%), Germany (11%), and France (7%).

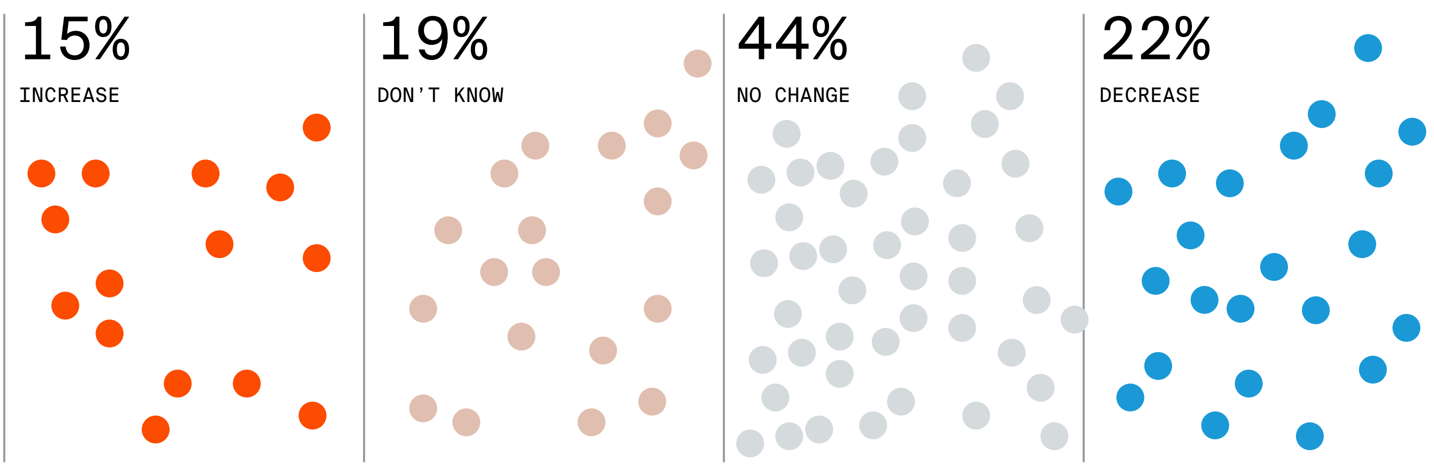
Nearly as common were transactions involving the United States (32%) and Canada (14%). And several respondents highlighted the attractiveness of deals between the two large North American countries.

"There is value to be had here in Canada," said Jim Friesen, founder of Portage M&A Advisory in Canada, **"as valuations and level of competition are typically lower here. With Covid restrictions being eased, cross-border deals will become much easier to navigate from a travel perspective."**

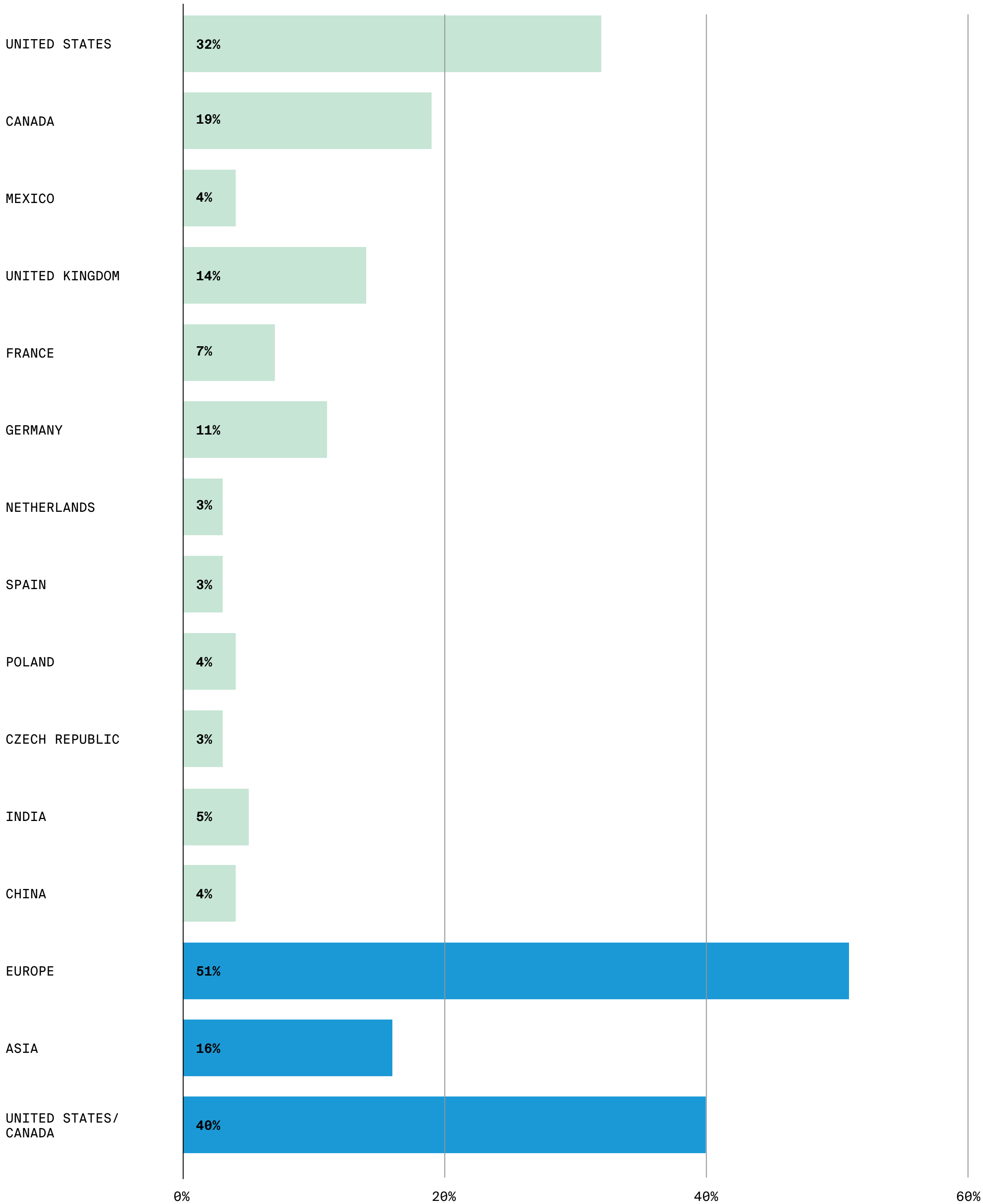
How do you see inbound cross-border transactions changing in the markets you work in (Foreign buyers acquiring in my country)?



How do you see outbound cross-border transactions changing in the markets you work in (Buyers in my country acquiring overseas)?



With what countries are you seeing the most cross-border deals?



Buyer Interest

High prices certainly haven't scared off buyers. Indeed, half the respondents (49%) say the number of buyers who are active in the market is increasing. Only 12% say there are fewer buyers.

Advisors in North America see more of an increase in buyers (54%) than those in Europe (36%). Few Europeans, however, see a decrease in buyers (15%). Most (43%) just see the buyer pool remaining the same.

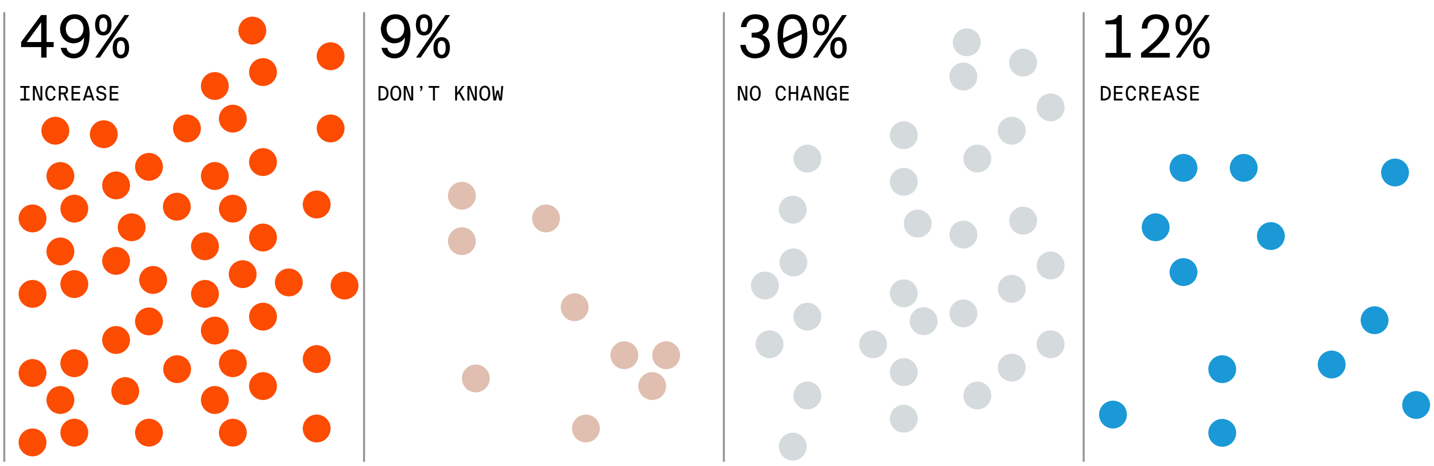
Private equity funds continue to be the dominant buyers of mid-sized companies. More than half (56%) of the advisors say private equity firms and other financial buyers were increasingly active. Even more (64%) say that companies owned by PE firms are increasingly active.

It's hardly a surprise then that business consolidation, a favorite tactic of private equity, is increasingly the motivation for deals. Some 63% of advisors said that "adding geography or customers" is an more common motive. The same proportion say "rolling up smaller companies" is increasing.

Only 19% of respondents say that there is an increase in companies doing deals to prepare for a public offering. The same number see IPO-related deals declining.

Special Purpose Acquisition Corporations (SPACs) were the only type of buyer on the wane. Some 27% of advisors say SPAC activity is declining compared to only 11% that said it is increasing.

How is the number of buyers active in the market changing?



Observations

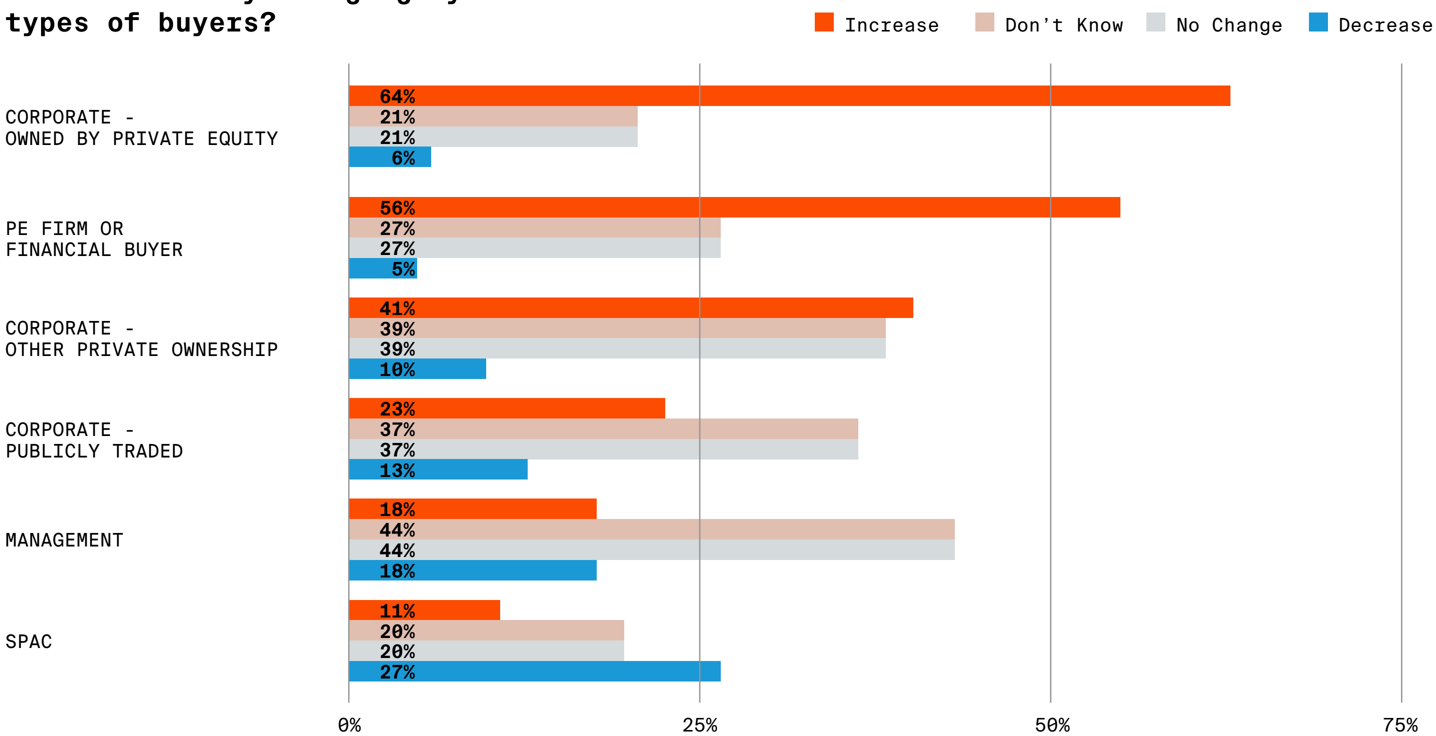
There is a declining interest in SPAC deals and an increase in private equity to private equity deals.
—Lawyer, United States

Buyers are looking to reduce asking prices and putting more value in the earn out.
—Colin Marson, Managing Partner at Lisergy Consulting, United Kingdom

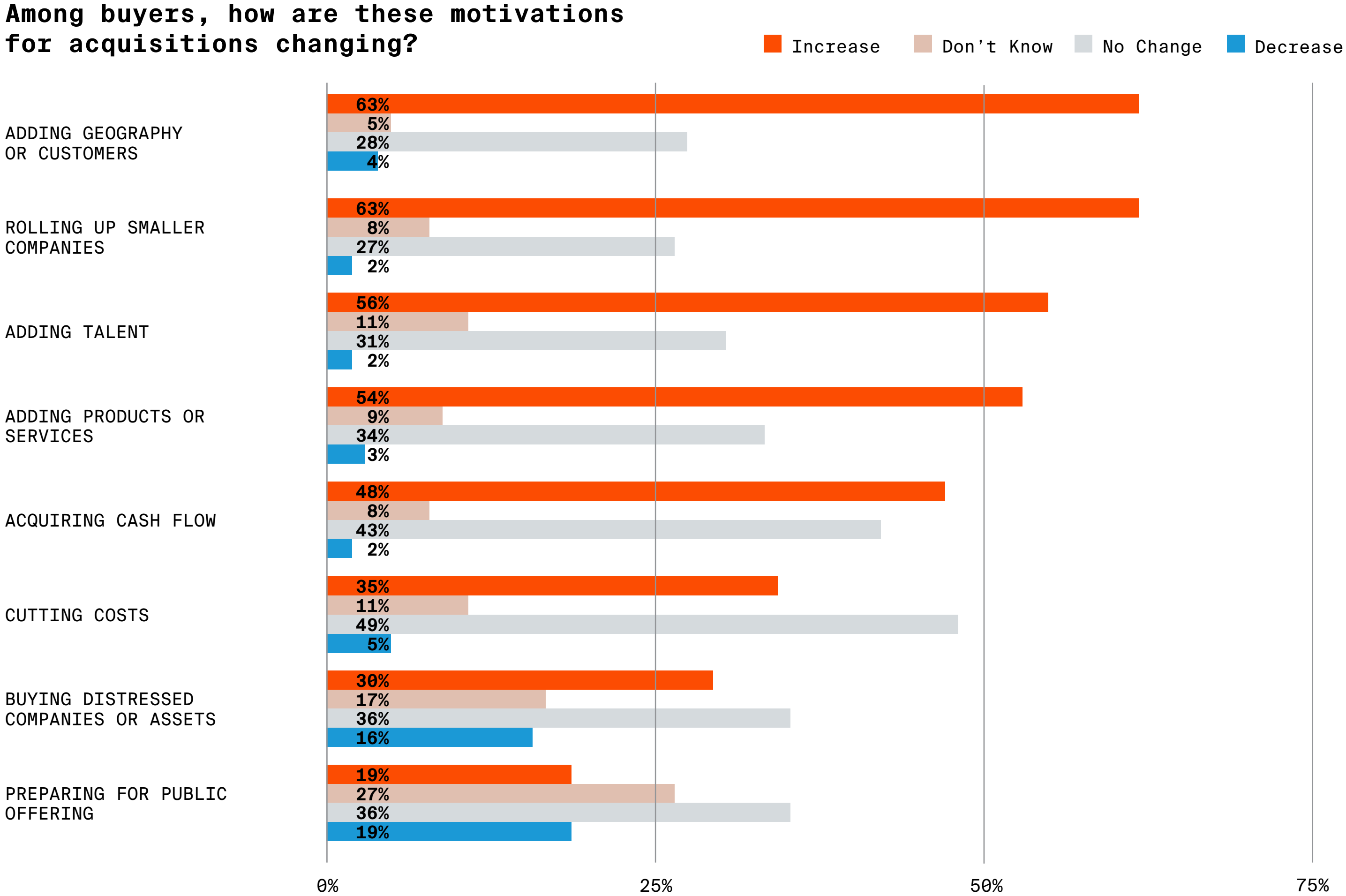
Buyers are more cautious with valuations and more focused on risk assessment.
—Investment Banker, Hungary

Labor shortages are certainly prevalent, and we are seeing more strategics acquiring businesses in order to add to their talent pool. ***—Jim Friesen, Founder of Portage M&A Advisory, Canada***

How is activity changing by these types of buyers?



Among buyers, how are these motivations for acquisitions changing?



Seller Interest

In the face of relentless interest from private equity funds and other acquirers, small business owners have been more than eager to sell this year. More than half of the advisors (52%) see a rising number of companies putting themselves on the block. Only 9% see the ranks of sellers declining.

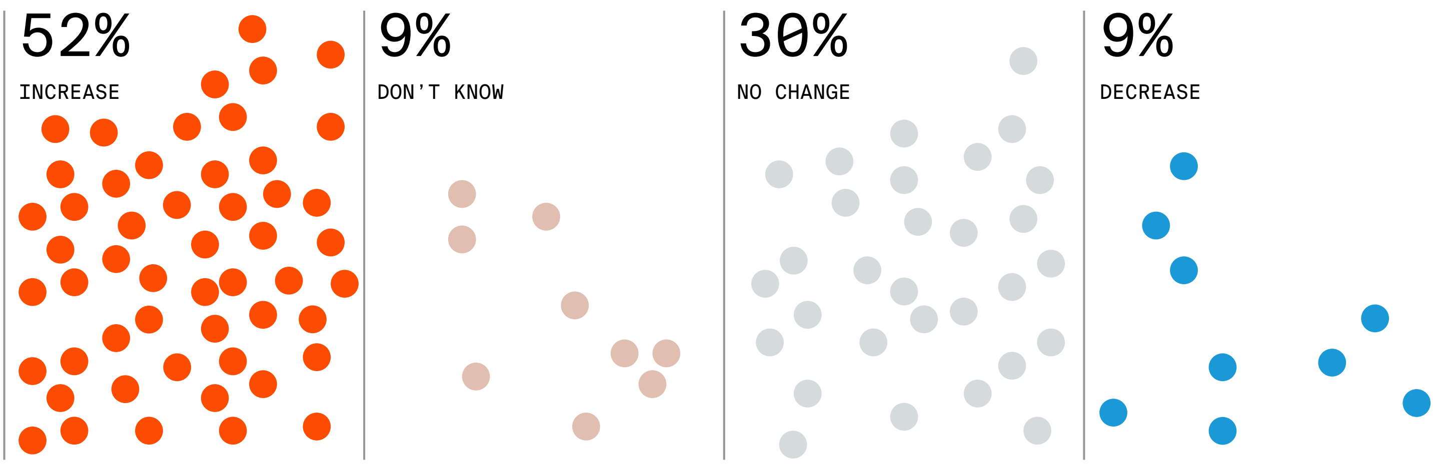
"Owner-operators are fatigued due to Covid, supply chain problems, and labor challenges," said Tom Schmidt, managing director of Norton McMullen Corporate Finance in Canada. **"That leads to more interest in selling."**

As with buyers, the increase in sellers is more apparent to advisors in North America (59%) than those in Europe (34%).

Not only are PE funds the most active acquirers they are also becoming a major source of companies for sale. Half the respondents (51%) say companies owned by private equity funds are increasingly being sold. Only 16% see an increase in publicly traded companies up for sale.

As for why companies decide to sell, 68% of advisors say that the retirement of the owner is increasingly a motivation. Only 21% say divesting part of the company is a growing motive for sale.

How is the number of sellers active in the market changing?



Observations

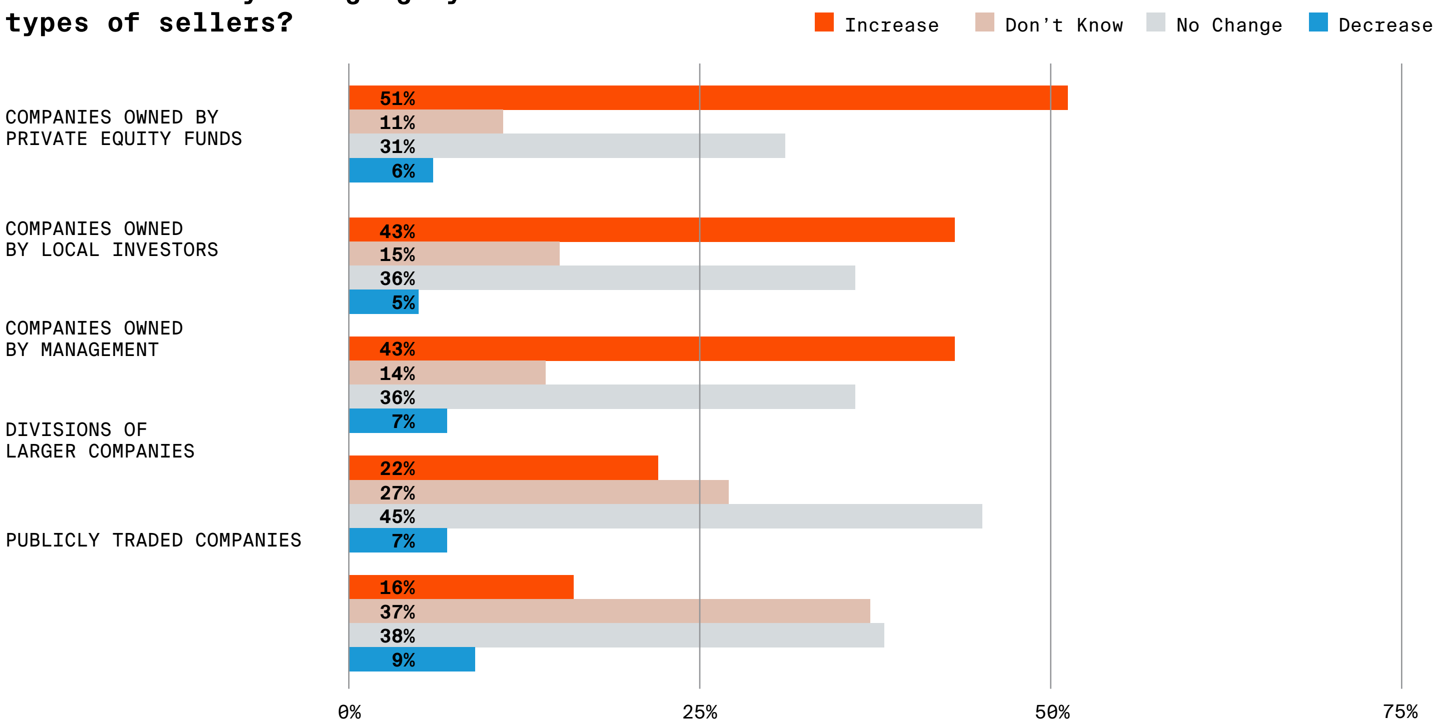
Sellers are becoming aware of the strong appetite from buyers. This, coupled with future uncertainty, high prices for commercial real estate, labor shortages, and supply chain issues, has increased the number of sellers going to market. ***—Jim Friesen, Founder of Portage M&A Advisory, Canada***

Instead of getting capital from traditional sources, sellers are looking for capital from private equity.
—Daniel Ryeys, Partner at Moreno Law, Mexico

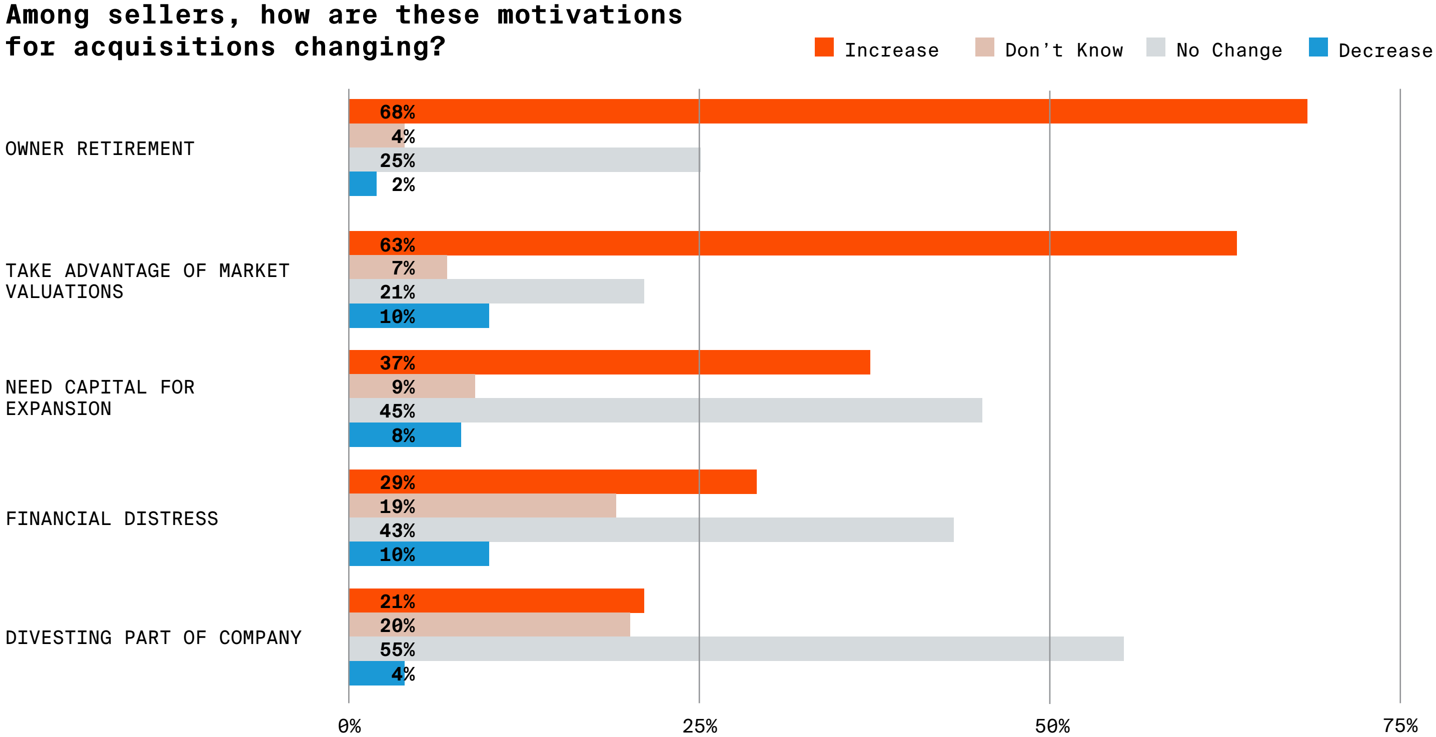
There are fewer sellers, and it is getting hard to find a good deal. Everybody's door has been knocked on many times. ***—Mark Borkowski, President of Mercantile Mergers & Acquisitions, Canada***

More sellers, tired from the pandemic, are re-evaluating their personal goals and timelines.
—Liz MacRae, Co-Founder and Head of Partnerships at Village Wellth, Canada

How is activity changing by these types of sellers?



Among sellers, how are these motivations for acquisitions changing?



Overall Mood

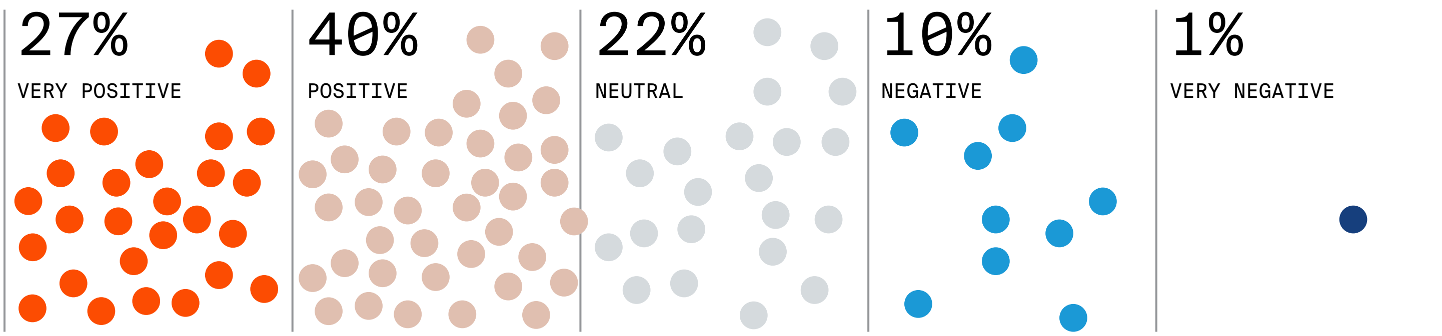
To pull these strands together, we asked the advisors whether they were feeling positive or negative about the market over the next three months. Two-thirds (66%) say they are feeling positive. Of those, 27% are very positive. Only 11% feel negative or very negative.

Middle market advisors may be upbeat now, but they were even more so when we surveyed them in the second half of 2021. In the third quarter, 73% were feeling positive, as were 79% in the fourth quarter.

Going back to the second quarter of last year, the mood was similar to today, with 60% feeling positive and 11% negative.

As we've seen throughout, the M&A market looks better to those in North America, where 72% of advisors are feeling bullish, than in Europe, where just half (51%) are positive.

As a whole, how are you feeling about the M&A market over the next 3 months?



Observations

I cannot predict the future clearly at this point. Even the Covid effect was caught up after a short break, which was not predictable after the first reactions in capital markets. ***—Investment Banker, Germany***

Demographic drivers for generational transfer, anxiety, uncertainty, external stress factors adding to dysfunctions in governance, high valuations and dry powder in funds, and the flow of money to safer economies all contribute to the buoyancy of the M&A market. ***—Feyer Faridian, Managing Director at Newport LLC, United States***

Buyers — both strategic and financial — are still active. They're seeing good returns in resilient private companies at significantly lower multiples than public companies.
—Candice Hartwell, M&A Advisor, VEER Business Advisors, Canada

Sellers are dealing with Covid fatigue, which has led to increased deal flow on the sell-side. Buyers remain motivated to acquire amid the increase in interest rates, which I anticipate will result in a strong dealmaking environment. ***—Jim Friesen, Founder of Portage M&A Advisory, Canada***

We continue to have an aging ownership group who are eager to exit due to "it's time" or concern over an uncertain future due to inflation and rising interest rates. ***—Business Broker, Canada***

Conclusions

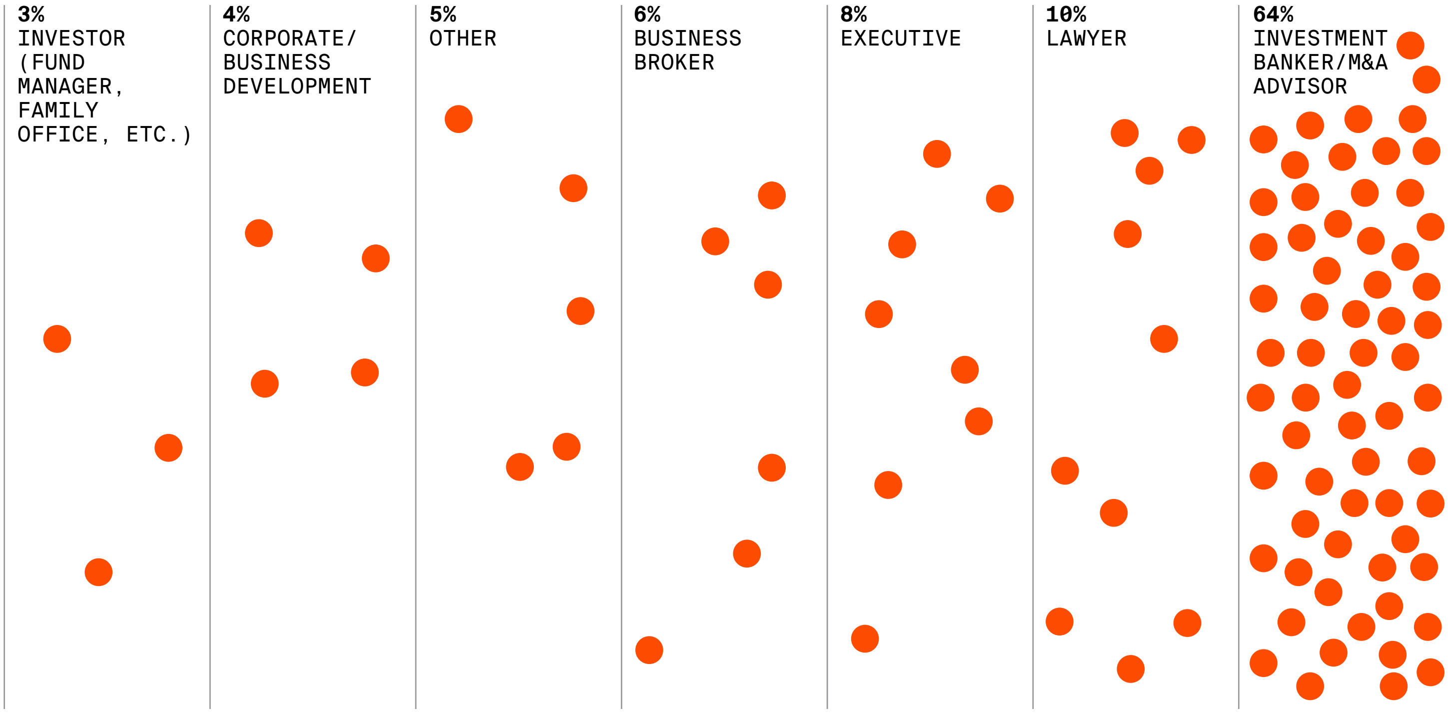
At this moment, the overall picture for the merger market is mixed. Advisors are bullish overall, more so in North America than Europe. Yet the number of announced deals is falling slightly in North America and while it is growing in Europe.

One explanation for the optimism among bankers is that some are looking beyond the short-term political and economic disruptions to longer-term fundamentals.

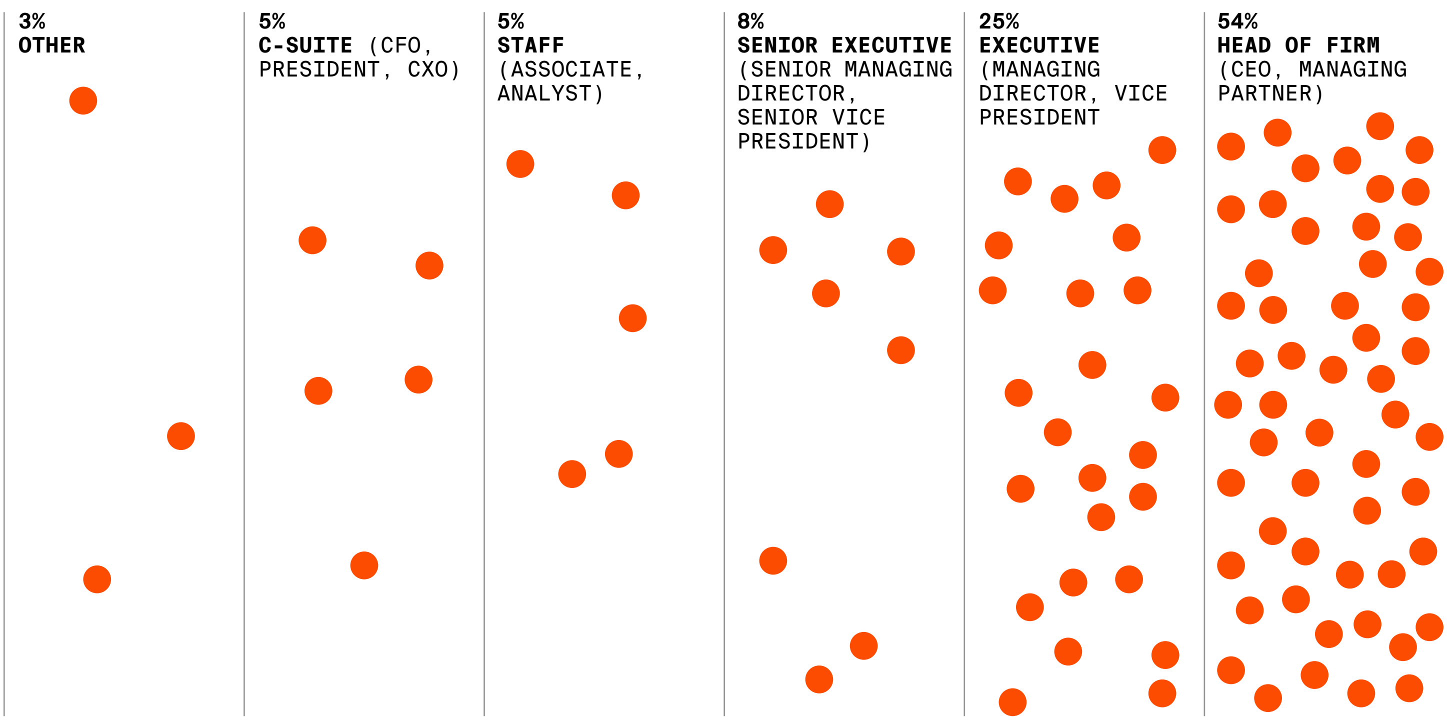
“Activity is increasing across the board,” said Liz MacRae, co-founder of Village Wellth in Canada. **“Innovative ideas are emerging, and collaborations are happening everywhere.”**

Appendix : Respondent Demographics

Which of the following best describes your current occupation?

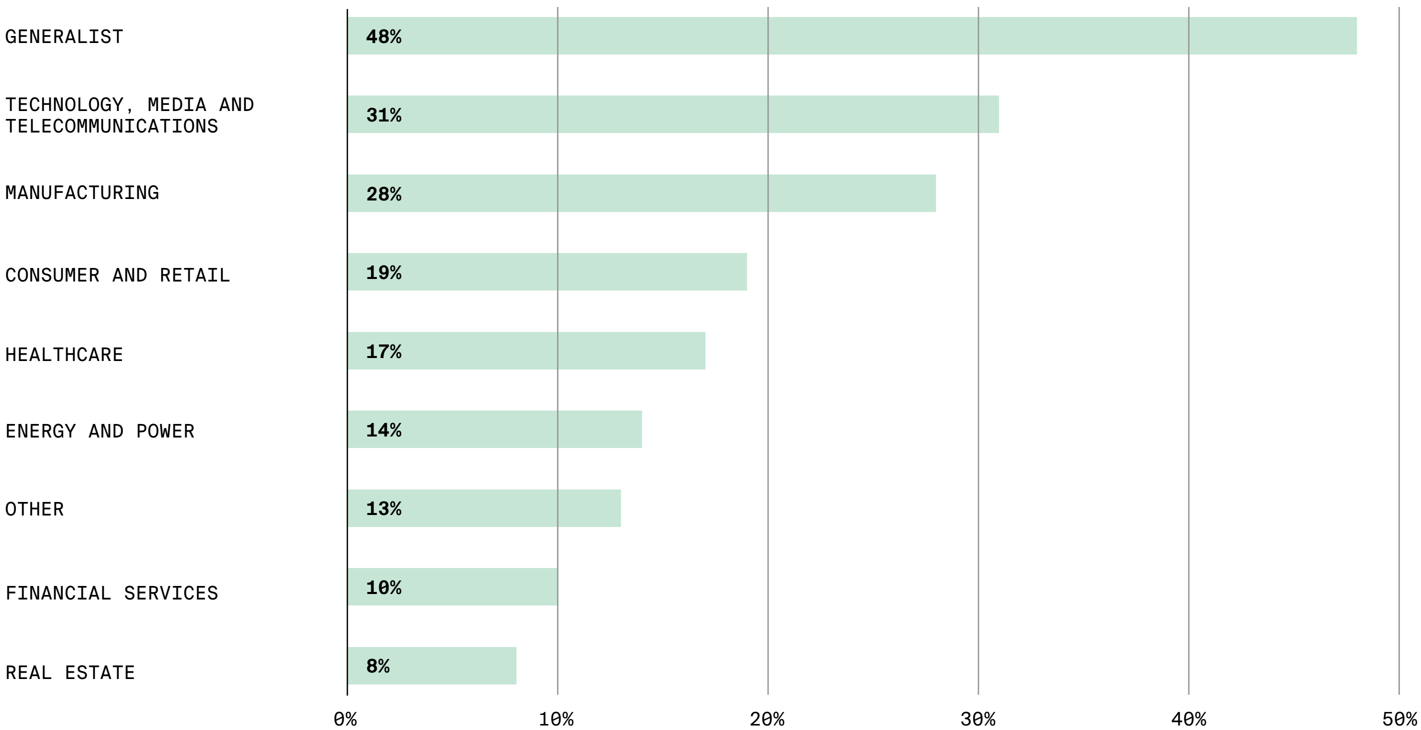


Which of the following best describes your job title?

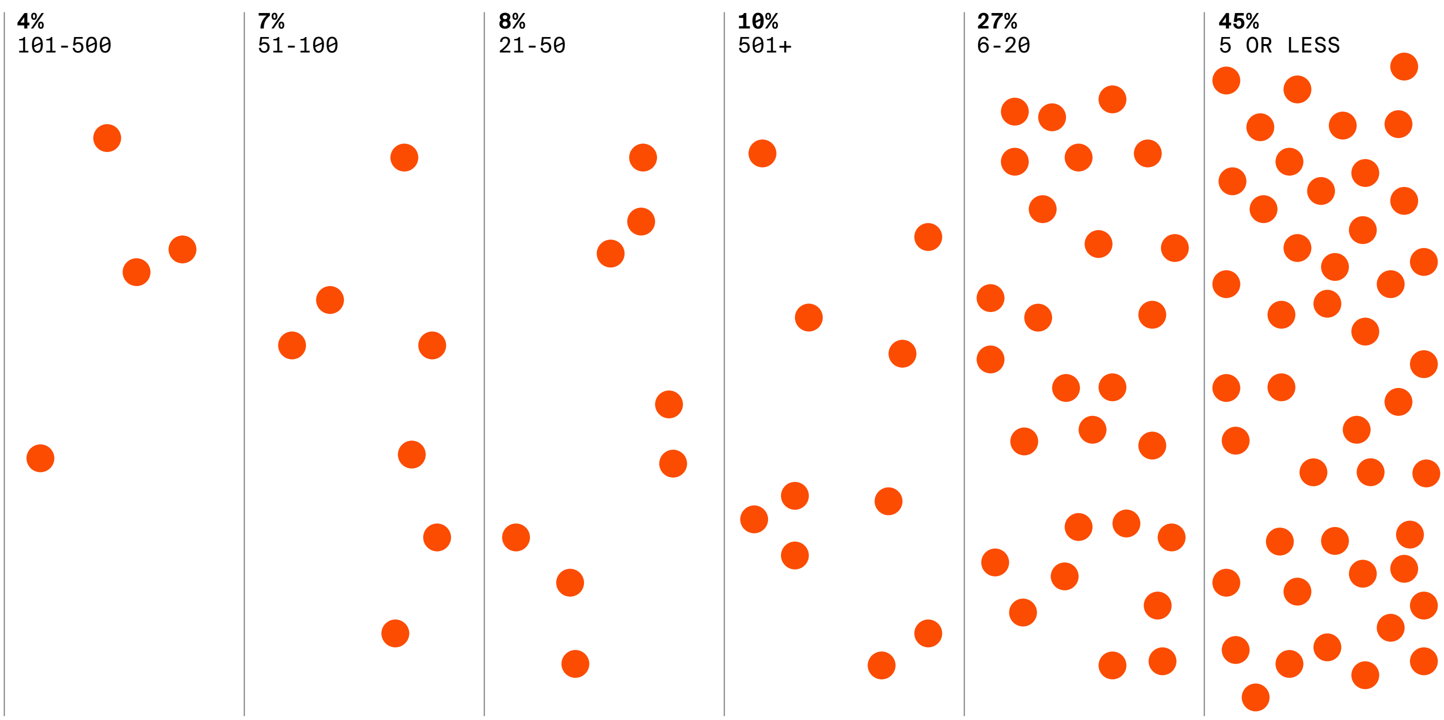


Appendix : Respondent Demographics *CONITINUED*

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

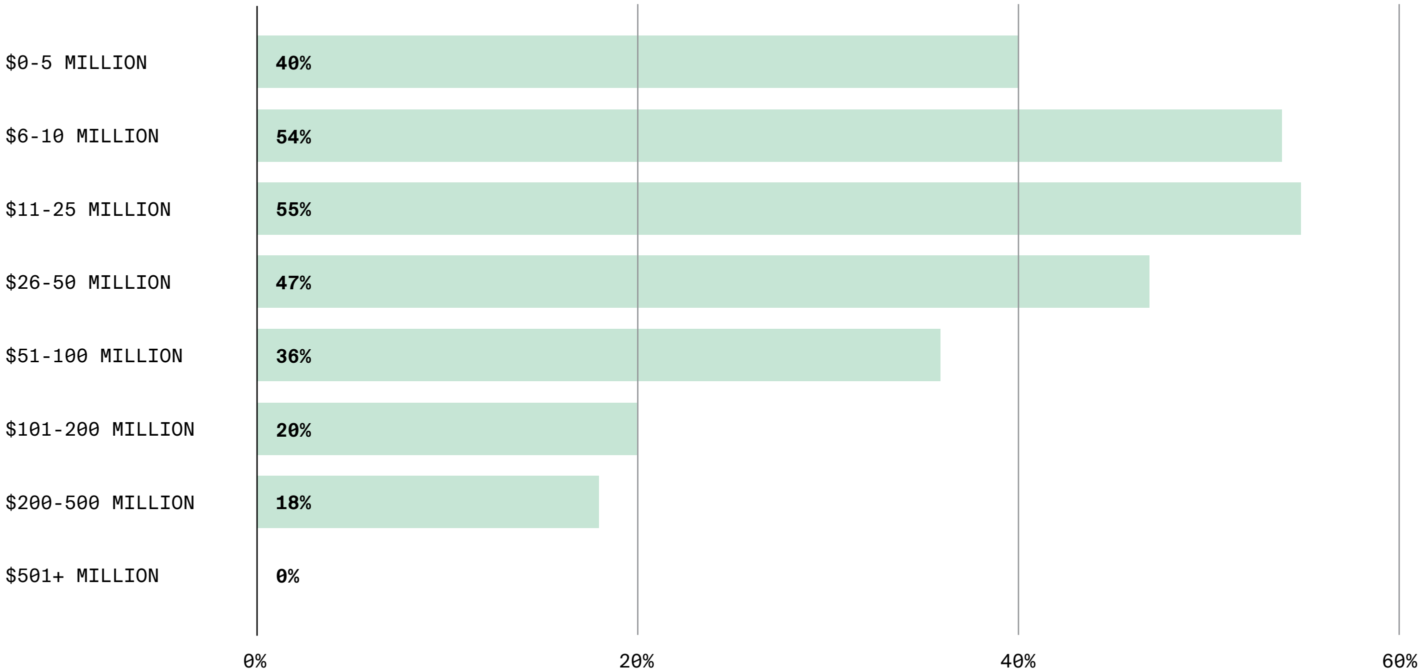


How many total employees does your firm have?

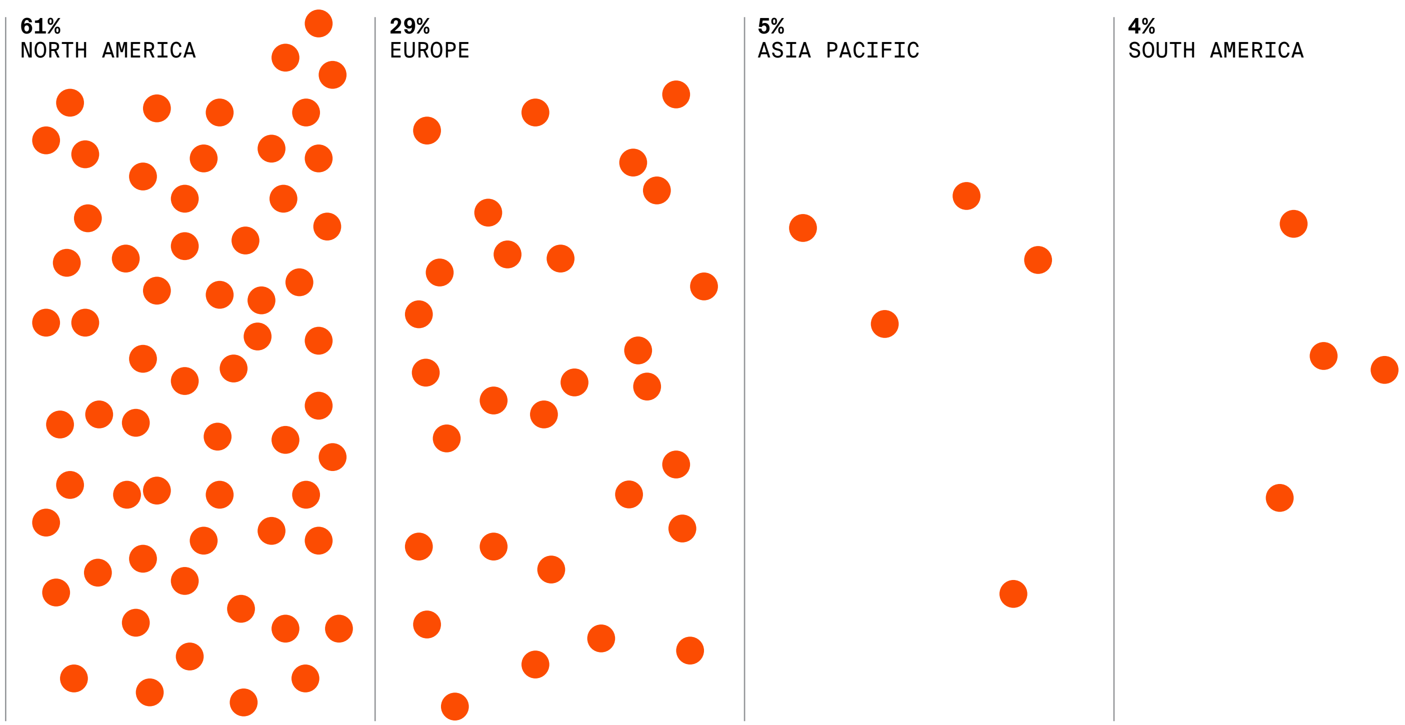


Appendix : Respondent Demographics *CONITINUED*

What size deals is your firm typically involved in? (Select all that apply.)



What region do you primarily work in?



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CONTACT FIRMEX

Mark Wright
General Manager
mwright@firmex.com

CONTACT SALES

North America:	+1.888.688.4042
Europe:	+44 (0)20.3371.8476
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