

Small Business M&A Report 2021

Hilton Smythe | October 2021





COVID-19 has had a profound impact on every area of business

As a company that helps people buy, sell and grow their business, we really do have some useful insight about the COVID-19 impact on the buying and selling of businesses.

From performance, to acquiring finance, and naturally, to buying and selling businesses. At Hilton Smythe, we believe that in order to best circumvent the challenges that the pandemic has brought upon the M&A market, it's important to fully understand them.

As such, we're making a point to take an in-depth look at how Covid-19 has impacted business. This report will examine the ways in which the pandemic has affected business performance, impacted the ways in which business owners have acquired finance, and ultimately, altered the greater landscape of buying and selling businesses.

Gareth Smyth, CEO Hilton Smythe Group.

Key stats on COVID-19 impact



+264%

MORE buyer enquiries on businesses for sale, post COVID-19.



+250%

MORE offers were received per businesses for sale, post COVID-19.



+66%

MORE buyer & seller meetings per businesses for sale, post COVID-19.



+188%

MORE deals agreed per businesses for sale, post COVID-19.

The data has been compiled by way of internal research, where we have analysed the relevant metrics, such as the number of businesses for sale throughout comparing the second half of 2020 and the first half of 2021 (post COVID-19), against the first and second half of 2019 (pre COVID-19).

Challenges during COVID-19



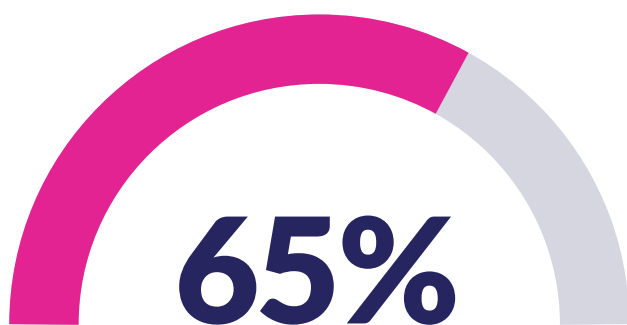
Workforce on furlough 2020



According to the UK Office of National Statistics* (ONS), the proportion of businesses' workforce on furlough leave was 19%, which equates to approximately 6 million people.

This led to unprecedented challenges for businesses of all sizes. It is also encouraging to note that conversely, 81% of businesses' workforce remained in work.

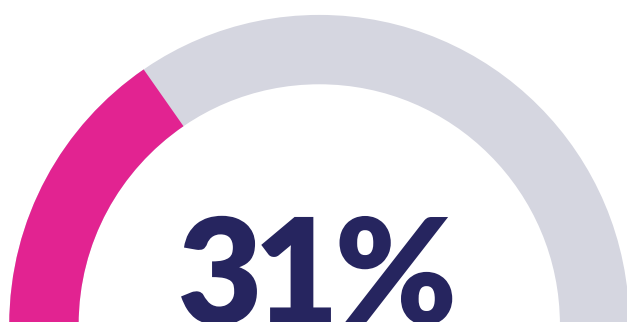
Decrease in turnover June 2020



According to the ONS report, prior to August 2020, the percentage of currently trading businesses experiencing a decrease in turnover, was consistently above 50%, reaching 65% in early June 2020 (when comparable estimates began).

We have not experienced a great deal of transactions where COVID-19 trade has negatively impacted the deal price.

Businesses with 3 months cash reserves or less



Due in part to Covid-19, the ONS shows that since November 2020, the percentage of businesses with three months' cash reserves or less has increased to approximately 31%.

The increase in companies with more than three months' cash reserves is perhaps contributing to the influx of interest in buying and selling businesses post lock downs.

*Figures taken from the Office of National Statistics' report, "How Corona virus and its Economic Impacts on the UK".

Businesses and their supply chains were under a great deal of stress



Issues from the procurement of raw materials, to the transportation of goods, to the reduced input of human labour greatly impacted the distribution process.



Many premises were ordered by law to close during lock-down, those that weren't faced multiple operational challenges: staff were not fully prepared to work from home, IT infrastructure being insufficient, lack of reliable IT equipment, and poor internet connections all presenting issues.



As a result, long-term planning was impossible, with decisions having to be made on a day-by-day basis in accordance with any government updates. Businesses still had to manage their cash flow and staff against these difficulties.



Some businesses were simply ill-suited to be transferred to a home environment. For those able to work remotely from home, there were additional challenges: a spotlight was shone on mental health, isolation, or workers who had childcare and parenting responsibilities during work hours.



Businesses had to manage the recovery of debtors, payments to suppliers and employees, and their own interests and debts. Many businesses would have filed for bankruptcy if it was not for government financial help. Others faced bankruptcy even with government assistance.



Preparing accounts

Workers involved in the preparation of accounts were faced with additional technical challenges, including:

- Difficulties acquiring information from management and non-management resources
- Difficulties in accessing workplace, such as offices, factories or warehouses
- Access to key management resources who could have been redeployed to other areas of the business on a short-term basis
- Issues in assessing the impact of cash flows
- Breach of (bank) covenants which could lead to cash flow problems.

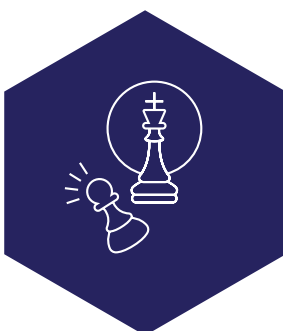
And for anyone involved in the preparation of the financial statements, it was very apparent that these were key issues to ensure the quality, thoroughness and accuracy of their work.



Managing cash flow

However, issues were not limited to financial statements alone, but were seen in every aspect of managing cash flow. Whether a business was in its initial start-up phase, in the process of growth, or even decline, the problem of finding the required resources to pay the bills was almost universal.

Due to the pandemic, some businesses have had to reduce their number of employees through layoffs, the furlough scheme, or through reduced hours. These business changes have resultantly had a dramatic impact on operations, with more responsibility often being put on fewer workers. For many, loss of work meant a reduced income. As a result, people have also been unable to support their local businesses, adding to the cycle of reduced cash flow.



Client dependence

Every type of business needs to make the most of its relationship with its client in order to succeed. However, many companies saw just how dangerous it is to rely on a specific demographic alone. Companies that were dependent on the support of a particular group were put in a precarious position as the pandemic had a profound impact on long-term growth. When a customer base was unable to maintain their custom, cash flows were disrupted, payments were late, non-existent, or pricing had to change in order to accommodate the clients' needs.



Digital concerns

Going digital has been a natural response for small businesses to attract a larger audience. Never was this truer than during the pandemic, when businesses had no choice to close their brick-and-mortar stores and to focus on the online side of their operations. However, not every business owner was well versed in the process of launching an e-commerce platform for their company. What's more, not every business fully lent itself to an online platform.

Fundamentally, businesses take time, funds, and know-how to transition to the digital sphere and build an audience. Social media, newsletters, and subscriptions can help, but it's worth noting that the period it takes to grow an online following, often exceeded the window in which businesses had to transition while staying afloat. For some businesses, the switch to e-commerce was their first experience with building up an online brand and developing a new base for customers to interact and as a result they struggled.



Getting remote working right

As the world was told to work from home, it became immediately apparent that there was insufficient time and support to help every member of the workforce make such an adjustment. For many workers, it was difficult to establish a balance, as priorities shifted while taking care of personal obligations such as looking after children, elderly, etc. For some, it was difficult to establish boundaries and priorities between business and personal lives. For others, improper home offices and internet connections hampered productivity. Many workers were simply feeling low, isolated and lethargic, and were unable to fully commit to work.

One of the challenges was establishing a healthy work-life balance despite the two environments (home and work) occurring in the same location. For some people, it was difficult to come up with strategies to deal with the mental fatigue, and with low morale becoming an issue for employers and employees alike, it became important to stay connected. As such, Zoom, Google Hangouts, Skype, and other video chat services became the norm. The aim was that regular communication, along with virtual team bonding efforts, would help prevent individuals to feeling burnt-out, isolated, and would help lift negative attitudes, feelings of hopelessness, and uncertainty.

Our data on buying and selling businesses



Impact of COVID-19 on buyer activity

Buyer activity for Hilton Smythe during the pandemic has not been as gravely affected as perhaps was first feared. The below section will give a summary of how business sales were affected by the rapidly changing economic conditions set off by the COVID-19 pandemic and the roll-out of the CBILS (Corona virus Business Interruption Loan Scheme) and RLS (Recovery Loan Scheme) across 2020-21 and how Hilton Smythe adapted and thrived during this difficult time to service its clients, throughout the UK and throughout various sectors.

2019-2020



Demand leading up to the end of 2019 and into early 2020 was strong. Buyers and sellers began to air on the side of caution as we approached mid-February 2020 and the market came to a complete standstill briefly when the UK went in to lock-down due to the COVID-19.

March-April 2020



From March, April, and May of 2020, deals which had been agreed and were progressing through the legal stages fell apart, with very few deals completing. Sellers withdrew their businesses from the market in droves, and the market looked somewhat bleak.

June-July 2020

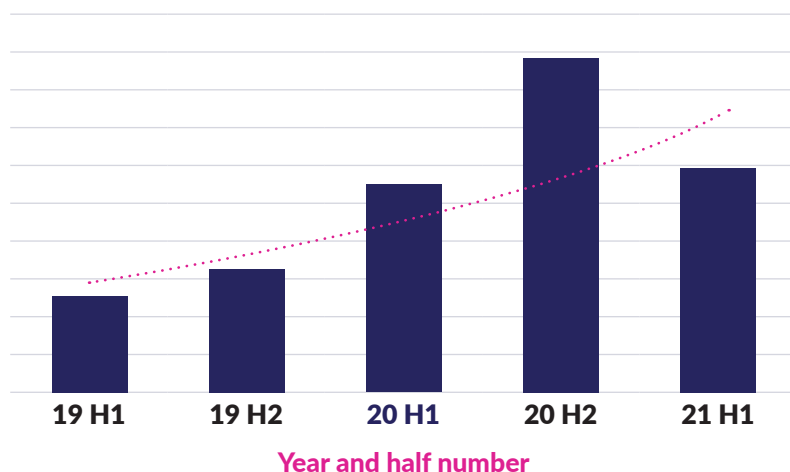


Fast forward to June and July of 2020 and the market was starting to show early signs of recovery, albeit with some pessimism. Lock-down clearly led to several buyers who were no doubt bored at home, enquiring on any remaining businesses that were for sale.

2020-2021

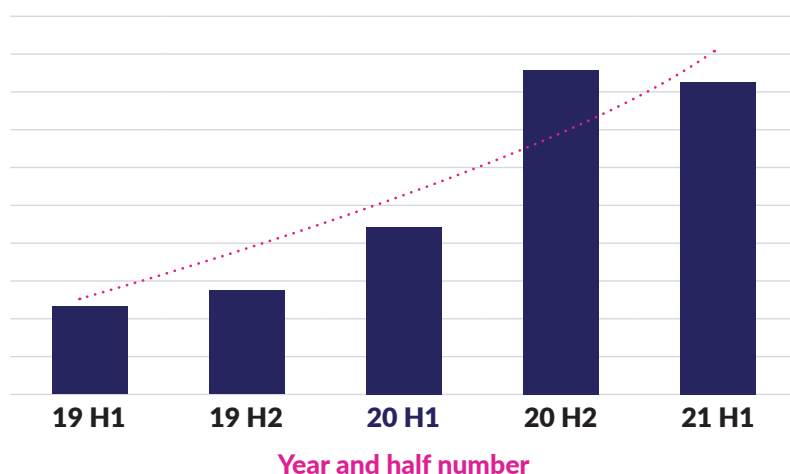
Leading into the second half of 2020 and indeed the first half of 2021, all metrics had caught up and were in fact ahead of pre-covid ratios. Meetings between buyer and sellers were increasing beyond pre-covid levels as too were offers on businesses for sale, as well as the number of sales agreed.

Volume of buyer enquiries per business for sale



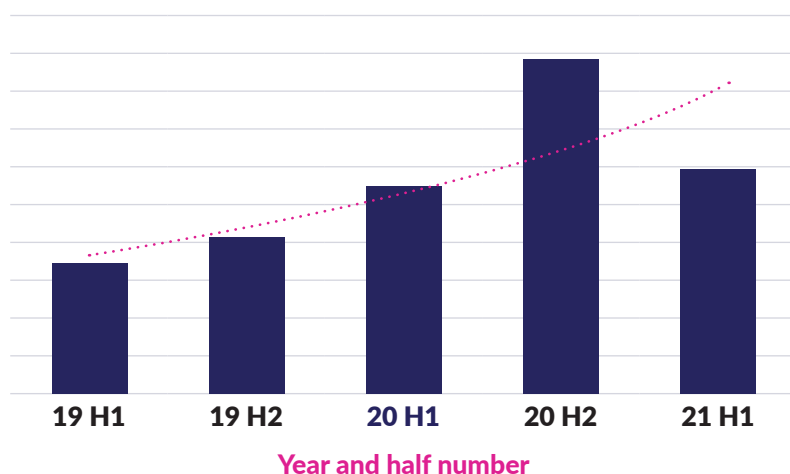
Graph showing the per unit average volume of enquiries from prospective buyers of businesses that were for sale with Hilton Smythe during the period covering half 1 2019 through to half 1 2021.

Volume of offers per business for sale



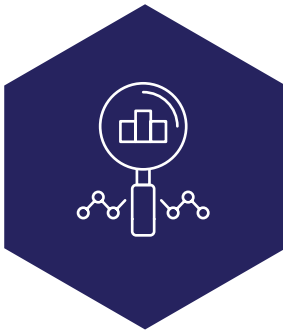
Graph showing the per unit average volume of offers from prospective buyers of businesses that were for sale with Hilton Smythe during the period covering half 1 2019 through to half 1 2021.

Volume of sales agreed per business for sale



Graph showing the per unit average volume of sales agreed from prospective buyers of businesses that were for sale with Hilton Smythe during the period covering half 1 2019 through to half 1 2021.

As we move into the second half of 2021, we remain very optimistic in respect of selling small and medium businesses across a range of sectors.



Impact of COVID-19 on business valuations

The COVID 19 pandemic has resultantly put an increased spotlight on valuation. Equity and debt holders have been keen to understand their risks and returns. Management teams and investors have been careful to make informed decisions. All the while, organisations have still required reliable estimates to fulfil their regulatory responsibilities.

Of course, this has been no easy feat. The unpredictable nature of movements in markets and the economy at large, along with increasing debt levels have all complicated the process of providing accurate valuations. This has led to increased uncertainty and greater difficulties in valuing businesses accurately.

Although it has been more difficult to deliver accurate valuations, it's far from impossible. Valuations now need to consider not only the usual market trends, but the wider impact of COVID 19 on growth rates and margins. For example, the pandemic has created a high level of uncertainty in the ways we have listed at the start of this report.

Although tried and tested valuation methodologies are still valuable, the data needed to inform valuations has changed. Valuations have to be amended to account for potential future volatility, for example a future lock-down brought about by the spread of the Delta variant would significantly impact the valuation of businesses in the hospitality sector. In the era of COVID 19 business valuations must therefore take into account a wide variety of data, rather than just narrower indicators of business performance.



What this means for Hilton Smythe





The impact of COVID-19 on the sale of small businesses has been a positive one

When the pandemic first hit, there was an immediate, knee-jerk need for financial safety nets. Fortunately, acquiring finance was made easier with the BBLS and CBILS. This was no doubt since the government paid the first 12 months' interest on a claimant's behalf, along with any upfront fees under these schemes.

Although the RLS didn't pay these upfront costs, it became the better alternative for smaller businesses once the BBLS was closed for applications. This was because it offers the provision of smaller loan amounts, starting at £25,001. As business brokers, there is no doubt that our valuation methodologies are still evolving following the impact of the pandemic. However, we are confident in our ability to weather the storm, providing accurate insights in spite of disruptions to the wider market.

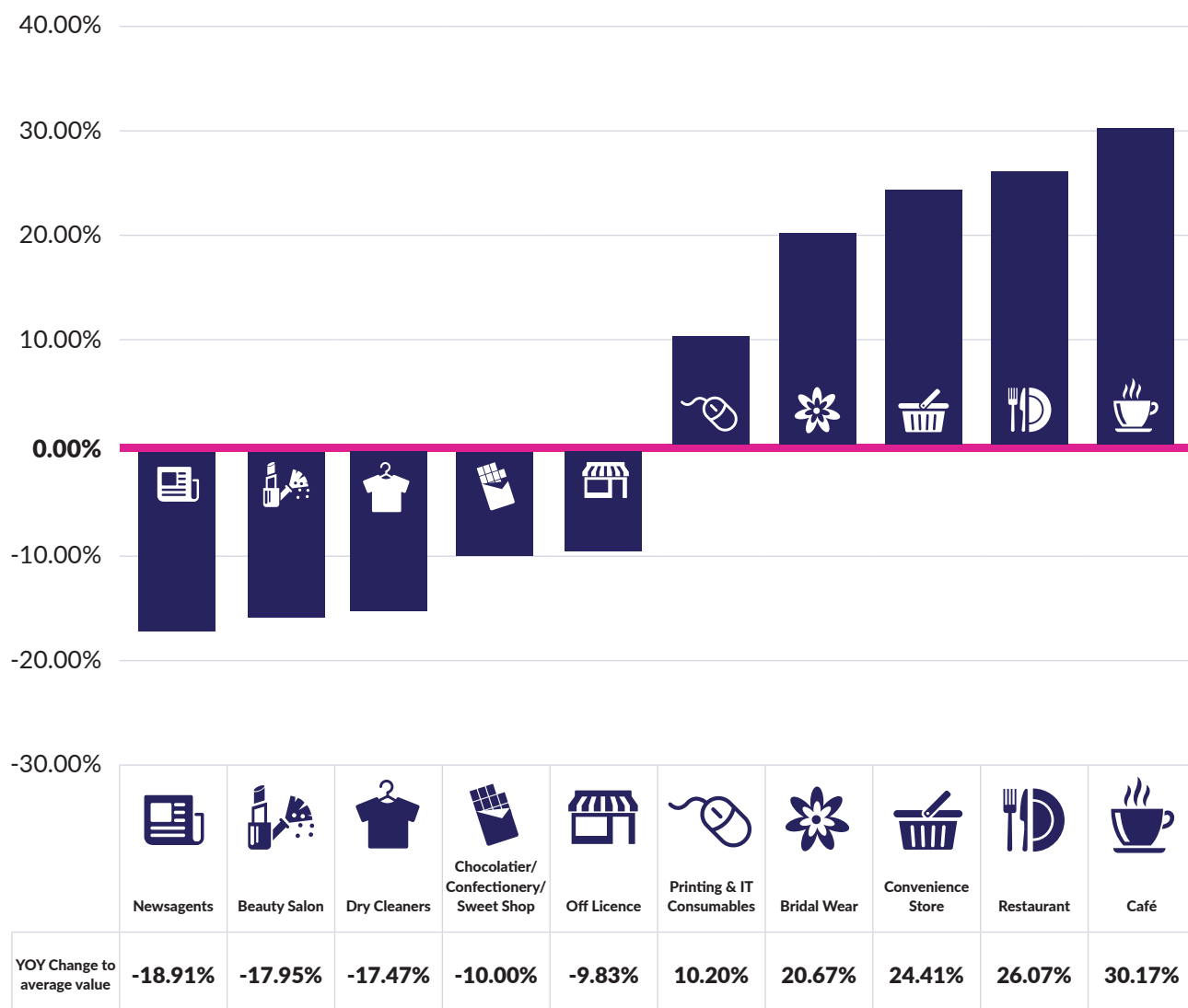
In conclusion

From what we've seen, the consequences of the pandemic may not have been as dire as expected. And, as we move into the second half of 2021; we remain very optimistic in respect of selling small and medium businesses across a range of sectors.

Despite an initial period where deals failed to complete during April-May 2020, the pandemic has not had long-term catastrophic impact on business sales. However, it could be argued that COVID-19 has exposed and accelerated the ways in which certain sectors may be supplanted by digital or alternative business models. For instance, a customer would have been able to find news content, beauty supplies and confectionery either digitally, at the supermarket, or through an online subscription service. However, they would have had no alternative way of acquiring 'the dining out experience' as provided by the hospitality sector. In conclusion, our findings have indicated that COVID-19 was less so a 'levelling' force, affecting business in an equally negative way, but a catalysing one, hampering sectors that are less able to adapt to the consumption habits of the digital age.

As the business world continues to recover from the pandemic, we are primed to aid buyers and sellers across all sectors. As such, we have recently expanded our team, placing an emphasis on sales and valuations.

Main valuation winners and losers by sector (High Street)



Although there have been undeniable losses for UK businesses, decline has not been universal. In fact, the sectors that have seen growth and decline have been unsurprising: newsagents, beauty salons, sweet shops and off licences are examples of businesses that have seen a decline during the pandemic. Unfortunately, smaller businesses of this nature – particularly those who have been unable to rely on finance - have been especially vulnerable during the pandemic, resulting in wide scale SME closures. As such, consumers who would have perhaps gone out of their way to support said businesses may not have had a choice, but instead, have been buying their newspapers, beauty supplies, and alcohol at their local supermarket.

Alternatively, businesses in the hospitality sector, such as cafés and restaurants have been met with growth (30.17% and 26.0%) respectively, indicating that once social distancing measures were relaxed, the enthusiasm in which the public supported these businesses, outweighed any decline experienced during their closures.

Glossary

BBLs – Designed for smaller businesses, the Bounce Back Loan Scheme (BBLs) aimed to help business owners access finance more quickly during the corona virus outbreak. The scheme closed on 31 March 2021.

CBILs – The Corona virus Business Interruption Loan Scheme was a larger-scale scheme, designed to support UK businesses that were losing greater quantities of revenue and saw their cash flow severely disrupted because of the COVID-19 outbreak. However, it's important to note that as of July 2021, the scheme has been closed to new applications. CBILs was available through a range of accredited lenders and partners. A lender could provide up to £5 million in the form of term loans, overdrafts, invoice finance and asset finance.

RLS – The Recovery Loan Scheme was introduced as a replacement for CBILs, aiming to provide access to finance for UK businesses as they attempt to recover from the COVID-19 pandemic. As such, the scheme was designed to help businesses of any size access loans and other kinds of finance so they can recover after the pandemic and transition period. The lending amount is set to a potential maximum of £10 million per business and the government guarantees 80% of the finance to the lender. The scheme is currently open until 31 December 2021.



Helping you buy, sell and grow.

For more information or to talk to one of our Business Advisers email us at enquiries@hiltonsmythe.com
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