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MARKETPULSE

QUARTERLY SURVEY REPORT

FIRST QUARTER 2014

IBBA INTERNATIONAL BUSINESS BROKERS ASSOCIATION, INC.®

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MARKET PULSE SURVEY REPORT
FIRST QUARTER 2014

The International Business Broker Association (IBBA) and M&A Source present the Market Pulse Quarterly Survey Report in partnership with ongoing research conducting by the Pepperdine Private Capital Markets Project at Pepperdine University's Graziadio School of Business and Management. The national quarterly Market Pulse survey was created to gain an accurate understanding of the market conditions for businesses being sold in the Main Street market (values $0 to $2 million) and lower middle market (values $2 million to $50 million). The survey was conducted with the intent of providing a valuable resource to business owners, potential purchasers, and their advisors.

The first quarter 2014 survey was completed by 250 respondents from 42 states. The majority of respondents (54 percent) had at least 10 years of experience in the M&A industry. Participating advisors reported closing 235 transactions in first quarter 2014.

MARKET SEGMENTS STUDIED

MAIN STREET	LOWER MIDDLE MARKET
< 500K	$2MM-$5MM
$500K-$1MM	$5MM-$50MM
$1MM-$2MM	

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 70-plus page document of up-to-date relevant information on the state of the marketplace and compiled by Dr. Craig Everett, assistant professor of finance at Pepperdine University's Graziadio School of Business and Management and director of the Pepperdine Private Capital Markets Project.

To become a member, please contact the IBBA and M&A Source headquarters at admin@ibba.org or (888) 686-4222.

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BOOMERS & RETIREMENT

New this survey, advisors reported that 65 percent of their new sellers and 41 percent of their buyers were baby boomers in first quarter 2014.

"The older boomers are selling and the younger boomers are buying," said Scott Bushkie, president of Cornerstone Business Services. "The boomers are affecting both sides of the transaction, helping create more activity on top of the strong interest from corporations and private equity to grow through acquisition. It's easy to see why activity is at an all-time high for the last five years.

"That said, the Main Street market remains a buyer's market," Bushkie continued. "It's unlikely values will increase as long as there's a larger number of baby boomers selling than there are buyers looking for Main Street opportunities. We'd need to see other market scenarios take precedence for valuations to change."

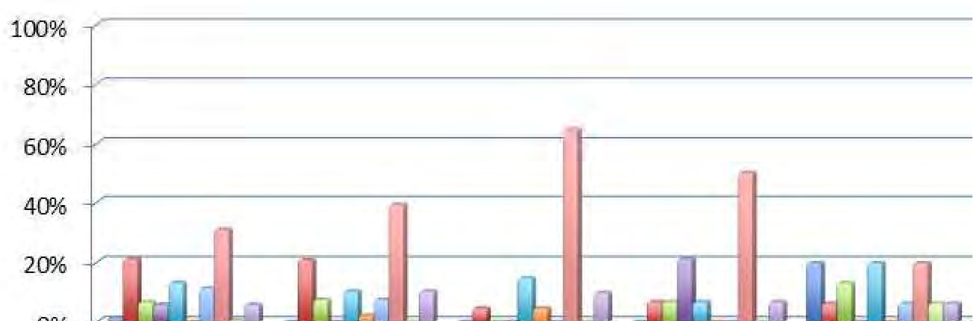
For Main Street, retirement was the number one reason driving sellers to market, followed by burnout. Notably, in the lower middle market, the $5 million to $50 million sector showed the greatest diversity of sale drivers we've seen since the survey began, with retirement, new opportunities, and acquisition all tied at 20 percent, followed by family issues at 13 percent.

"The reason we're seeing retirement share the spotlight with acquisitions and new opportunities most likely stems from an increase in unsolicited bids," said Michael Camerota, president of Touchstone Advisors. "With the larger number of buyers and their record amounts of *dry powder*, many buyers are getting more aggressive. They're hiring M&A advisors or putting a deal team in place to seek out proprietary deal flow and avoid competing in the competitive auction process for a company that's formally on the market."

"As for health issues spiking in the $2 million to $5 million sector, that could be tied to a number of older boomers who should have started selling around 2008 or 2009 but decided to hold on through the Great Recession," said Cress Diglio, with Transworld Business Advisors. "We can expect that health issues could continue to pop up as a key driver until most of the older boomers have exited the market."

> ***"The older boomers are selling and the younger boomers are buying."***
>
> **–SCOTT BUSHKIE**

Figure 1: Reason to Market



	< 500K	500K - 1M	1M - 2M	2M - 5M	5M - 50M
Acquisition	2%	0%	0%	0%	20%
Burnt out	21%	21%	5%	7%	7%
Family issues	7%	8%	0%	7%	13%
Health	6%	0%	0%	21%	0%
New opportunity	13%	11%	15%	7%	20%
Potential taxes increases	0%	3%	5%	0%	0%
Relocation/moving	12%	8%	0%	0%	7%
Retirement	31%	39%	65%	50%	20%
Unsolicited offer	1%	0%	0%	0%	7%
Other	6%	11%	10%	7%	7%

> “All the data suggests that lower middle market M&A will continue to play in sellers’ favor.”
>
> –DR. CRAIG EVERETT

VALUATION MULTIPLES

Valuations are the same or somewhat better than they were in the previous quarter. According to the Market Pulse Report for Q4 2013, advisors projected that valuations would stay the same or increase only slightly in Q1 2014. Market performance matched expectations, demonstrating that advisors in the trenches really do have a good grasp of what’s going on in the marketplace.

Compared to last quarter, valuations were up only slightly in three market sectors. But year over year the lower middle market is showing multiples at one point lower or more. Valuations are still strong, however, and lower middle market data points to a seller’s market, meaning the metrics are there for pricing to remain healthy.

“All the data suggests that lower middle market M&A will continue to play in sellers’ favor,” said Dr. Craig Everett, director of the Pepperdine Private Capital Markets Project at Pepperdine University’s Graziadio School of Business and Management. “Active buyers, available cash, aggressive financing, cheap debt—these are all aligned for strong price points.”

Figure 3: Deal Structures Q1 2014 vs. 2013

	Q1 2014	Q4 2013	Q1 2013
<$500K	2 (SDE)	2 (SDE)	2 (SDE)
$500K-$1MM	2.6 (SDE)	2.5 (SDE)	2.6 (SDE)
$1MM-$2MM	3.1 (SDE)	3 (SDE)	3.5 (SDE)
$2MM-$5MM	4.3 (EBITDA)	4 (EBITDA)	5.75 (EBITDA))
$5MM-$50MM	4.5 (EBITDA)	4.5 (EBITDA)	5.5 (EBITDA)

FINANCING: SENIOR DEBT AND SELLER EQUITY

For the most part, banks are funding a larger percentage of deals. Consequently, seller financing has declined to an average of 20 percent for Main Street deals and 14 percent for the lower middle market, compared to 22 percent and 19 percent a year ago.

Figure 3: Deal Structures Q1 2014 vs. 2013

	2014			2013		
	Equity	Senior Debt	Seller Financing	Equity	Senior Debt	Seller Financing
<$500K	65%	15%	17%	66%	4%	21%
$500K-$1MM	37%	37%	23%	44%	28%	24%
$1MM-$2MM	23%	49%	12%	40%	22%	20%
$2MM-$5MM	18%	59%	12%	23%	39%	24%
$5MM-$50MM	43%	29%*	15%	40%	15%*	13%

**In the $5--$50 million category Mezzanine debt financing was 6 percent in 2014 vs. 26 percent in 2013.*

These finding are consistent with reports from the Small Business Administration which indicates 13 of the nation’s largest banks increased lending by $17 billion in the last two years. That more aggressive lending approach is playing out in both Main Street and lower middle market deal structures.

“We can look to the lending climate as one factor in current valuations, which continue to remain strong,” said Dora Lanza, principal at Plethora Businesses. “With financing available and relatively cheap, buyers can better leverage their equity to get deals done.”

SOURCES OF BUYER EQUITY

Survey results indicate that home equity lines of credit (HELOC) are playing a more significant role in financing lower middle market deals in 2014. HELOC financing was conspicuously absent in these categories in Q1 2013. This reintroduction of HELOC loans is consistent with reports of increased lending activity.

"Buyer confidence is growing," said Len Krick, president of Sunbelt Business Brokers of Las Vegas. "They're not just using the liquid cash they have, but they're cashing out their 401Ks, taking additional mortgages out on their homes, and tapping friends and family for help to get a deal done. You don't take those kinds of risks unless you're confident you can succeed."

"Buyer confidence is growing."

–LEN KRICK

Figure 4: Sources of Buyer Equity

	$2MM - $5MM	
	2014	**2013**
Cash	50%	50%
401K/IRA Rollover	8%	13%
Home Equity (HELOC)	17%	0%
Friends/Family	17%	25%
Other Investors	8%	13%
	$5MM - $50MM	
Cash	50%	75%
401K/IRA Rollover	8%	0%
Home Equity (HELOC)	17%	0%
Friends/Family	17%	0%
Other Investors	8%	25%

BUYER AND SELLER MARKETS

Consistently, we find that as the deals get larger, advisors are more likely to describe conditions as a seller's market. The shift continues to more of a seller market, year over year. But for businesses below $2 million in value, the survey continues to show that buyers can take advantage of some good values on the market.

Figure 5: Buyer versus Seller Markets

	Q4 2013		Q4 2012	
	BUYER	**SELLER**	**BUYER**	**SELLER**
<$500K	77%	23%	78%	22%
$500K-$1MM	63%	37%	69%	31%
$1MM-$2MM	58%	42%	54%	46%
$2MM-$5MM	40%	60%	50%	50%
$5MM-$50MM	36%	64%	35%	65%

"Many buyers are getting more aggressive."

–MICHAEL CAMEROTA

> "We're probably returning to more traditional timeframes, closer to pre-recession closing times."
>
> –STEVE WAIN

TIME TO CLOSE

Year over year, most deals closed faster in Q1 2014. This is consistent with recent survey trends.

"We're probably returning to more traditional timeframes, closer to pre-recession closing times," said Steve Wain, president of Calder Associates. "This is likely due to greater confidence on both the buy and sell side combined with more aggressive financing positions from lenders across the U.S."

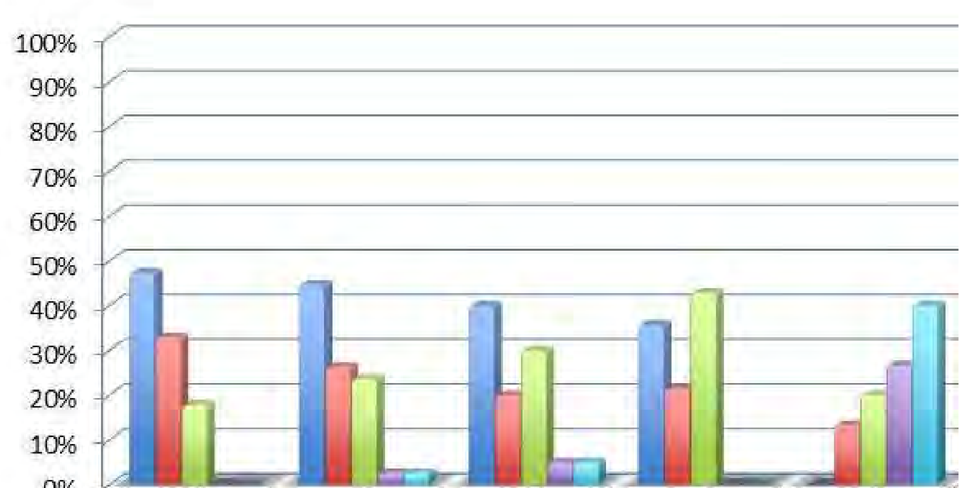
Figure 6: Median Time to Close (Months)

	Q1 2014	Q1 2013
<$500K	4	4
$500K-$1MM	5	6
$1MM-$2MM	6	9
$2MM-$5MM	8	10
$5MM-$50MM	11	7.5

BUYER TYPES

The Main Street market was dominated by individual buyers again this past quarter, most of them first time business owners. Existing companies had the strongest presence in the $2 million to $5 million sector at 43 percent. In the $5 million to $50 million sector, private equity groups were the primary players, representing 67 percent of closed transactions.

Figure 7: Buyer Types



	< 500K	500K - 1M	1M - 2M	2M - 5M	5M - 50M
1st time individual	47%	45%	40%	36%	0%
individual who owned a business	33%	26%	20%	21%	13%
existing company/strategic buyer	18%	24%	30%	43%	20%
PE firm - Platform	0%	3%	5%	0%	27%
PE firm - Add-on	0%	3%	5%	0%	40%

HOT INDUSTRIES

Restaurants, business services, and retail led the Main Street market. Manufacturing, business services, and healthcare were leaders in the lower middle market.

Figure 8: Hot Industries

	#1	#2	#3
<$500K	Restaurants – 21%	Business Services – 15%	Retail – 14%
$500K-$1MM	Business Services – 16%	Distribution – 13%, Personal Services – 13%	
$1MM-$2MM	Retail – 25%	NA	NA
$2MM-$5MM	Manufacturing – 29%	Distribution – 14%, Construction – 14%, IT – 14%	
$5MM+	Business Services – 27%	Health Care – 20%	NA

MISTAKES

Once again, advisors report that unrealistic expectations is the biggest mistake sellers make when trying to sell their business. Unrealistic expectations dwarfed all other pitfalls including declining business sales, burn out, poor financial record keeping, and emotional attachments.

EXPECTATIONS

Advisors expect new business will continue to grow in the next three months, with sentiment remaining strong at a 3.70 index on a five-point scale. An index above 2.50 indicates more advisors view market conditions as favorable than poor.

Expectations for valuation multiples also remains positive at a 3.14 index, indicating more advisors expect multiples to stay the same or better.

> ***"We can expect that health issues could continue to pop up as a key driver until most of the older boomers have exited the market."***
>
> **–CRESS DIGLIO**

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The Pepperdine Private Capital Markets Project reports on the current climate for privately held companies to access and raise capital, as well as the conditions influencing the decisions of lenders and providers serving small businesses and the lower middle market. Our ongoing research engages in multiple survey research initiatives and publishes an annual Capital Markets Report, an annual economic forecast, the PCA Index Quarterly Report in partnership with Dun & Bradstreet Credibility Corp. and Market Pulse Quarterly Report in cooperation with the International Business Brokers Association and M&A Source.

ABOUT INTERNATIONAL BUSINESS BROKERS ASSOCIATION (IBBA) AND THE M&A SOURCE

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.

Founded in 1991, the M&A Source promotes professional development of merger and acquisition professionals so that they may better serve their clients' needs, and maximize public awareness of professional intermediary services available for middle market merger and acquisition transactions.