MARKETPULSE

QUARTERLY SURVEY REPORT Q3 2012

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

MARKET SEGMENTS STUDIED

Figure 1

MAIN STREET	LOWER MIDDLE MARKET
Less than $499K	$2MM - $4.99MM
$500K - $1MM	$5MM and above
$1MM - $1.99MM	

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KEY FINDINGS

POTENTIAL TAX INCREASES:

Retirement was the number one reason for sale across all business sectors, except those valued at $5million and above. The second most common reason was burnout, followed by new opportunities at a distant third.
However, for business valued at $5million and above, survey respondents pointed to potential tax increases as the primary driver motivating a sale.

"Baby boomers represent more than half the business owners in the U.S., so it's no surprise that retirement is the number one reason for sale," said Chet Walden, CBI, M&AMI, president of Walden Business Inc, Atlanta, GA and chairman of the board, M&A Source. "Businesses over $5 million in value had more money to lose and were more keenly aware of the large potential tax rate increases coming in 2013. They decided to sell in 2012 in hopes of netting out more than they could after the new taxes take effect."

Respondents were asked to identify the impact of possible 2013 tax increases on the M&A market. The majority (57 percent) expected fewer sellers would go to market until they could get better clarity on the future. On the other hand, 26 percent said more sellers would try to go to market and close before the new taxes took effect. And 14 percent said sellers would be giving more concessions in order to close prior to the end of the year.

"For those businesses waiting to sell, I think it's safe to assume that many are waiting to move 2009 off their three-year-trailing financial reports," said John Paglia, associate professor of finance at Pepperdine University's Graziadio School of Business and Management and director of the Pepperdine Private Capital Markets Project. "Most sellers had a poor financial performance in 2009, and moving past that may make their businesses more salable. They're hopeful that better numbers will net them a little better value—even with the tax implications in consideration."

FINANCING:

Survey results showed a fairly significant increase in cash at close. For Q2, cash at close accounted for roughly 50 percent of deal financing across most sectors. For Q3, cash at close was at approximately 70-75 percent across all but the $5million-plus deals.

Figure 2: Cash at Close Q2 verses Q3

	Q2	Q3
<500K	75%	75%
$500K-$1MM	54%	70%
$1MM-$2MM	54%	71%
$2MM-$5MM	54%	74%
$5MM+	61%	55%

"In almost all sectors, the cash at close stayed the same or increased significantly," said Pino Bacinello CBI, M&AMI, president of Pacific Business Brokers, Vancouver, Canada and chairman of the board, IBBA. "We saw many sellers negotiate to get more cash at close and possibly gave concessions in other areas to get the structure that made the most sense to them, assuming they'll net more this year than in 2013 when taxes are expected to increase."

Survey results also showed that most brokers and M&A advisors believe that debt is slowly becoming more available in the market place especially as the deal size gets larger, but it still remains a hurdle in getting deals done.

Figure 3: Debt Availability

	MORE AVAILABLE	LESS AVAILABLE	NO CHARGE
<500K	26%	25%	49%
$500K-$1MM	33%	15%	52%
$1MM-$2MM	32%	15%	53%
$2MM-$5MM	36%	17%	47%
$5MM+	46%	8%	46%

MULTIPLES:

Multiples showed some notable shifts over the second quarter, increasing for businesses valued at $1million and greater. Multiples for businesses of $1million or less showed some movement downward or remained relatively the same.

Figure 4: Multiples by Deal Size

MAIN STREET	SDE	EBITDA
Less than $500K	64% @ 1.5-3.0x	
$500K - $1MM	80% @ 2.0-3.0x↓	77% @ 2.0-3.5x
$1MM - $2MM	81% @ 2.0-4.0x↑	31% @ 5.0x↑
LOWER MIDDLE MARKET		
$2MM - $5MM		72% @ 4.5-6.0 ↑
$5MM and above		76% @ 4.5-6.5 ↑

* Up and down arrows indicate notable movement over Q2 2012.

SDE = Seller's Discretionary Earnings
EBITDA = Earnings Before Interest, Taxes, Depreciation And Amortization
Transactions in the Main Street market are typically based on multiples of SDE, while those in the lower middle market are most commonly based on EBITDA. In some instances survey respondents reported multiples for both SDE and EBITDA.

BUYER AND SELLER MARKETS:

Brokers in the Main Street market were less likely to describe conditions as a "buyer's market" than they were in Q2. For the smallest deals valued at $500K or less, 60% of brokers said it was a buyer's market (versus 70 percent in Q2). But as deal size got larger, advisors were progressively more inclined to describe conditions as a "seller's market."

In the lower middle market, advisors described it as a "seller's market" by a 2 to 1 ratio for deals of $5MILLIONS and above (41 percent seller's versus 20 percent buyer's). This, too, is a significant shift toward a seller's market sentiment over Q2.

WHAT'S SELLING:

In the Main Street market, for business valued at $500K or less, business services led sales at 38 percent, followed by retail (13 percent), and restaurants (13 percent). For businesses valued between $1-2 million, the "hottest" industries were at a three-way tie at 18 percent for consumer goods/retail, healthcare/biotech, and wholesale/distribution. For businesses valued between $1-2 million, manufacturing led at 24 percent, followed by wholesale distribution (21 percent), and consumer goods/retail (15 percent).

In the lower middle market, manufacturing and construction led the way, tied at 27 percent for businesses in the $2-$5million sector. For businesses sold at $5million or above, 50 percent were in construction.

BUYER TYPES:

Private equity purchases were almost nonexistent until opportunities reached $5million in value. In this study, private equity dominated purchases of $5million and above, at 68 percent of deals closed. Of those, nearly all were add-on acquisitions with one private equity platform deal.

For Main Street businesses, buyers were primarily individuals (75 percent). Of those individual buyers, more than half (60 percent) were first time buyers.

MARKET SENTIMENT:

In Q2, brokers and intermediaries anticipated an upward swing in the M&A market. At that time, 46 percent to 58 percent expected new listings to increase by sector, with Main Street brokers showing the greatest optimism. In Q3, brokers reporting that deals increased varied from 26 percent for deals valued between $2-5million to 40 percent for deals in the <$500K sector and the $500K-$1million sector.

Figure 5: Respondents Reporting Deal Increases by Sector

	Q3
<500K	40%
$500K-$1MM	40%
$1MM-$2MM	35%
$2MM-$5MM	26%
$5MM+	37%

Note: Data does not show that deals increased by x percent but rather the percentage of advisors indicating deals had increased in a particular sector. Also note that respondents do not represent clients across all five deal sectors.

Intermediaries representing all sectors are optimistic they will gain new clients in the next quarter, varying from 51 percent for $5million-plus sector to a high of 59 percent for <$500K, representing a jump over Q2 expectations.

BUYER PROXIMITY:

New in the Q3 survey, brokers and intermediaries were asked where buyers were located in relation to the business sold. Notably, deals over $5million in value garnered the largest percentage (88 percent) of out-of-state buyers.

Local buyers within a 20mile radius were the most common buyer group until deals exceeded $5million in value. Less than 10 percent of businesses in all sectors were sold to an international buyer.

Figure 6: Buyer Proximity

MILES	20	50	100	OUT OF STATE	INTERNATIONAL
<500K	60%	13%	7%	16%	4%
$500K-$1MM	33%	13%	21%	28%	5%
$1MM-$2MM	44%	9%	9%	32%	6%
$2MM-$5MM	40%	13%	20%	20%	7%
$5MM+	-	13%	-	88%	-

BROKER ADDENDUM

FEE STRUCTURE:

For deals valued at $500K or less, 33 percent of advisors charged a retainer and/or a monthly fee in addition to commission. As deal sizes grew, advisors were progressively more likely to charge retainers and monthly fees, jumping to roughly 60 percent for deals in the lower middle market.

LEAD GENERATION:

Again, brokers and intermediaries report that their best new client arrived by referral (55 percent). When asked how they received their best client in the past three months, 31 percent pointed to a referral from past clients and 21 percent to accountant referrals.

"You can see that it pays to spend time networking and building relationships with small business advisors," says Lisa Riley of Scottsdale, AZ. "Of course it also pays to keep in touch with past clients as they are the number one way people get their best clients."

TERMINATIONS AND MISTAKES:

Brokers and intermediaries continue to cite unrealistic expectations (51 percent) and declining business sales (17 percent) as the most common reasons deals failed to close. These figures are almost identical to Q2 results.

"For the M&A broker who wants a sustainable business, spending time up front to set clear, realistic expectations with the seller is an absolute must," says Barry Berkowitz, CBI, Boynton Beach, Fla. "The biggest mistake a broker can make is saying yes to the owner of a business that's overpriced. Not only do you have very little chance of selling, but you'll use up many valuable hours that could have been used to sell a realistically priced business."

A full copy of the IBBA and M&A Source Market Pulse Survey is available to IBBA and M&A Source members. This is a 70+page report of up-to-date relevant information on the state of the marketplace compiled by the Pepperdine Private Capital Markets Project under Dr. John Paglia. To receive your copy, please contact the IBBA and M&A Source headquarters at admin@ibba.org or (888) 686-4222.

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