

Q2 2018



INTERNATIONAL BUSINESS BROKERS ASSOCIATION | M&A SOURCE | PEPPERDINE PRIVATE CAPITAL MARKETS PROJECT

MARKETPULSE

QUARTERLY SURVEY

SECOND QUARTER 2018





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 100-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 and director, Pepperdine Private Capital Markets Project.

To become a member, please contact the IBBA and M&A Source.

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THE IBBA AND M&A SOURCE MARKET PULSE

SURVEY REPORT Q2 2018



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 Main Street (values \$0-\$2MM) and the lower middle market (values \$2MM-\$50MM). The national survey was conducted with the intent of providing a valuable resource to business owners and their advisors. The IBBA and M&A Source present the Market Pulse Survey with the support of the Pepperdine Private Capital Markets Project and the Pepperdine Graziadio Business School. The Q2 2018 survey was completed by 277 business brokers and M&A advisors. Respondents completed 251 transactions this quarter.

FIGURE 1: MARKET SEGMENTS STUDIED

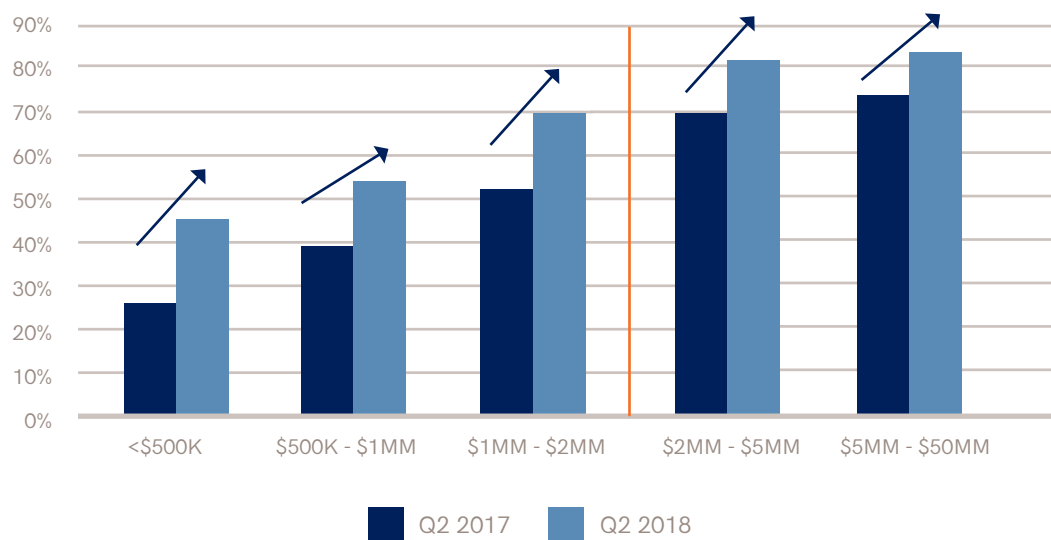
MAIN STREET	LOWER MIDDLE MARKET
Less than \$500K	\$2MM - \$5MM
\$500K - \$1MM	\$5MM - \$50MM
\$1MM - \$2MM	

Remarkable Time to Sell a Business

"Lower middle market too hot to touch," "M&A flies high," "M&A activity speaks to confidence of CEOs." This quarter's Market Pulse survey backs up the kind of headlines that have been dominating industry new feeds right now. It's a remarkable time to sell a business. Roughly 21% of advisors say 2018 is the best year they've ever seen for business owners to sell their businesses. Another 37% say it's the best time in five years, and 17% say it's the best in the last 10 years.

Consistent with general market optimism, advisors believe seller advantage is growing, with year-over-year seller-market sentiment increases in all market sectors. In the Main Street market, for businesses valued at less than \$500,000, seller market sentiment is at the highest it's been since the survey started in 2013.

FIGURE 2: SELLER'S MARKET SENTIMENT CLIMBING



Multiples and Cash at Close

Multiples remain high in most categories. In addition to strong valuations, sellers are getting more cash at close this quarter, matched with slight declines in seller financing.

FIGURE 3: MEDIAN MULTIPLES STRONG

	2018	2017	2016	2015	2014
	Q2	Q2	Q2	Q2	Q2
Median Multiple Paid (SDE)					
<\$500K	2.0	2.0	2.3	2.0	2.0
\$500K - \$1MM	2.5	2.3	2.8	2.5	2.8
\$1MM - \$2MM	3.3	3.3	3.3	3.0	3.1
Median Multiple Paid (EBITDA)					
\$2MM - \$5MM	3.8	4.3	4.0	4.0	4.5
\$5MM - \$50MM	5.9	5.4	5.1	5.0	5.4

FIGURE 4: SELLERS GETTING MORE CASH AT CLOSE

	Q2 2018				Q2 2017			
	CASH AT CLOSE*	SELLER FINANCING	EARN OUT	RETAINED EQUITY	CASH AT CLOSE*	SELLER FINANCING	EARN OUT	RETAINED EQUITY
<\$500K	83%	13%	2%		86%	12%	1%	
\$500K - \$1MM	81%	12%	4%		80%	16%	3%	
\$1 - \$2MM	80%	16%	1%	1%	71%	17%	7%	2%
\$2 - \$5MM	82%	12%	1%	1%	78%	14%	6%	
\$5 - \$50MM	80%	12%	5%	1%	64%	15%	3%	15%

*Cash at close reflects a combination of buyer's equity and senior debt.

"The current environment means there may never be a better time to sell your business" said Craig Everett, PhD, Director of the Pepperdine Private Capital Markets Project. "Capital is readily available from lenders, private equity firms, and family offices, and existing companies have record cash sitting on the sidelines. Interest rates are still relatively low, the economy is going strong with an estimated 4.3% GDP growth in Q2 2018, and business confidence remains high. Well-run companies are doing well in the M&A market right now."

"I've talked with other M&A advisors and the vast majority agree that if you're thinking of selling your business in the next three to five years, now is probably the time that you'll obtain the most value," said Scott Bushkie, president of Cornerstone Business Services.

Working Capital

The majority of Main Street and lower middle market businesses are selling without including working capital in the sale price.

FIGURE 5: MOST COMMON MULTIPLE TYPE BY DEAL SIZE

DEAL SIZE	MOST COMMON MULTIPLE TYPE
<\$500K	SDE w/o working capital
\$500K - \$1MM	SDE w/o working capital
\$1MM - \$2MM	SDE w/o working capital
\$2MM-\$5MM	SDE w/o working capital
\$5MM-\$50MM	EBITDA (tied w/ and w/o working capital)

* SDE Sellers Discretionary Earnings

* EBITDA Earnings Before Interest, Taxes, Depreciation and Amortization



Low Unemployment Could Hurt Main Street Transitions

Advisors are somewhat split on how the low unemployment rate is impacting business transitions. In the Main Street market, 28% of advisors believe talent shortages are hurting the ability to close deals while 16% say it's helping. Numbers look slightly different in the lower middle market, with 18% saying it hurts deal-making and 19% saying it helps.

"Organic growth is a challenge right now because businesses of every size are struggling to find qualified talent. Low unemployment can be a particular challenge for small and mid-sized businesses trying to compete," said David Ryan, an advisor with Upton Financial Group in California. "When it is hard to find talent, it is hard to grow organically, leading owners to grow through acquisition of existing businesses with staff who know their customers. But the talent dynamics can be a bit different in Main

Street where turnover is often higher," Ryan continued. "Buyers may be hesitant to take on an understaffed business or one that comes with a lot of hiring challenges."

But Sellers Have Plenty of Business Opportunities

After a sale, business owner goals vary. Roughly a third will stay engaged in some kind of business activity. Owners in both Main Street and the lower middle market display entrepreneurial tendencies, with 12% planning to start another business and 17% pursuing other business opportunities. About a fifth plan to travel after selling their business. Other top interests include moving to a vacation home and taking care of family.

Retirement continues to lead as the number one reason to sell across all sectors, followed by burnout and new opportunities.

FIGURE 6: TOP 3 REASONS SELLERS WENT TO MARKET

<\$500K	Retirement 31%	Burnout 17%	New Opportunity 16%
\$500K - \$1MM	Retirement 49%	Burnout 17%	Relocation 15%
\$1MM - \$2MM	Retirement 52%	New Opportunity 19%	Health 13%
\$2MM-\$5MM	Retirement 57%	New Opportunity 13%	Burnout 10%
\$5MM-\$50MM	Retirement 56%	(tie) Burnout 13%	Recapitalization 13%

"For many sellers, this is the time to take some chips off the table. Savvy business owners are taking advantage of the strong seller's market, even though they aren't ready to retire," said Mike Camerota, JD, M&AMI, CM&AP, Founder of Touchstone Advisors, M&A Source Chair.

"The idea is to maximize value by selling now, diversify their net worth, and then buy or start another business where they see opportunity."

Know Your Buyer

<\$500,000: BUYERS IN THIS SECTOR TEND TO BE:

- + First time buyers (49%), serial entrepreneurs (32%), or existing companies (17%)
- + Motivated to buy a job (50%), gain a horizontal add-on (16%)
- + Located within 20 miles (70%) or 50 miles (17%) of the seller's location

<\$500K-\$1MM: BUYERS IN THIS SECTOR TEND TO BE:

- + First time buyers (51%), serial entrepreneurs (29%), or existing companies (15%)
- + Motivated to buy a job (39%), gain a horizontal add-on (22%), or realize better ROI than other investments (17%)
- + Located within 20 miles (76%) or more than 100 miles (12%) of the seller's location

\$1MM-\$2MM: BUYERS IN THIS SECTOR TEND TO BE:

- + Existing companies (32%), first time buyers (32%), or serial entrepreneurs (29%)
- + Motivated to buy a job (32%) or realize better ROI than other investments (32%)
- + Located within 20 miles (40%) or more than 100 miles (33%) of the seller's location

\$2MM-\$5MM: BUYERS IN THIS SECTOR TEND TO BE:

- + Existing companies (33%), first time buyers (30%), or serial entrepreneurs (17%)
- + Motivated to realize better ROI than other investments (40%) or gain a horizontal add-on (30%)
- + Located more than 100 miles (50%) of the seller's location or within 20 miles (40%)

\$5MM-\$50MM: BUYERS IN THIS SECTOR TEND TO BE:

- + Existing companies (50%), private equity firms (26%), first time buyer (13%)
- + Motivated to acquire a horizontal add-on (38%) or vertical add-on (25%)
- + Located more than 100 miles (44%) of the seller's location, within 100 miles (25%), or within 20 miles (25%)

What Are They Buying?

Looking at the overall market, manufacturing, construction/engineering, business services, and personal services led among hot industries.

FIGURE 7: TOP INDUSTRIES BY MARKET SECTOR

<\$500K	Personal Services	Restaurants	(tie) Business Services, Consumer Goods
\$500K - \$1MM	Business Services	Construction/Engineering	Personal Services
\$1MM - \$2MM	Business Services	Manufacturing	(tie) Personal Services, Consumer Goods
\$2MM-\$5MM	Manufacturing	Construction/Engineering	Wholesale/Distribution
\$5MM-\$50MM	Manufacturing	Construction/Engineering	Information Tech.

"In Main Street, service businesses seem to be the most sought after at this point in time. These businesses are often asset-light, making them more affordable, adaptable and risk tolerant," said Nathan Pitcher of Industry Pro.

"As for the lower middle market, manufacturing continues to be the most sought-after business

quarter after quarter. That's especially true for those that produce a proprietary product versus contract manufacturing shops that rely on others for continued work orders."

Time to Close. The average time to close is 9.2 months, an increase from Q2 last year.

FIGURE 8: TIME TO CLOSE ON AN UPTICK

	Q2 2018		Q2 2017	
	MONTHS TO CLOSE	MONTHS FROM LOI TO CLOSE	MONTHS TO CLOSE	MONTHS FROM LOI TO CLOSE
<\$500K	7	2	6	2
\$500K - \$1MM	8	3	6	2
\$1 - \$2MM	9	3	7	3
\$2 - \$5MM	9.5	3.5	9	3
\$5 - \$50MM	12.5	3.5	9	5

"One of the reasons why it's taking longer to get to the closing table may be as markets peak, buyers suddenly become more focused on the value proposition because there is some fear of a possible decline in business," said Warren

Burkholder, CBI, President of NEVRG, Inc., IBBA Chair. "And buyers are paying a premium right now, so they're doing more due diligence to make sure they're getting what they think they are."

Main Street Isn't Planning

The majority of Main Street business owners fail to plan for the sale of their business. Advisors indicated that 89% of business owners in the <\$500,000 sector conducted no formal planning prior to engagement. Lower middle market business owners were more proactive, although 43% also failed to make advance plans to sell.

Even among business owners who do plan (Figure 10), only a few are working with any kind of professional advisor (e.g. CPA, wealth, attorney, broker) to discuss exit strategies a year or more in advance.

FIGURE 9: BUSINESS OWNERS WHO ENGAGED IN NO FORMAL PLANNING BEFORE ENGAGEMENT

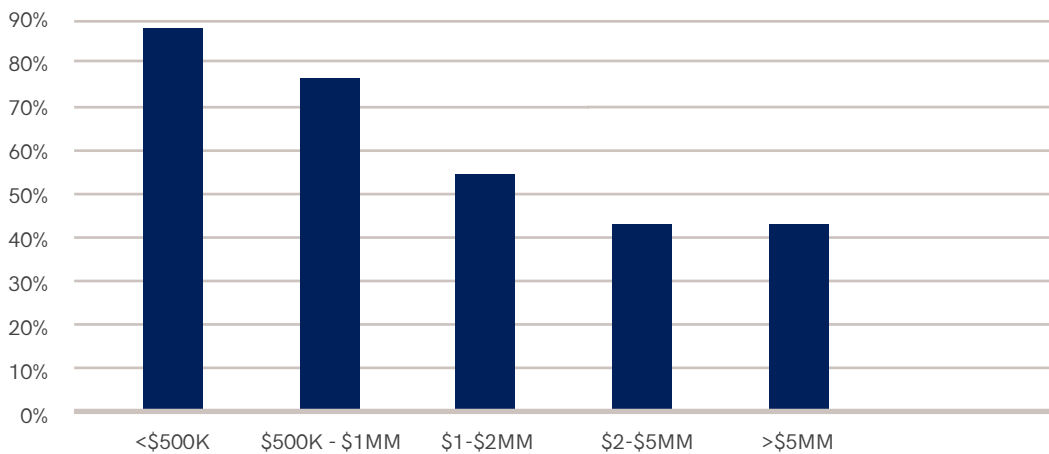
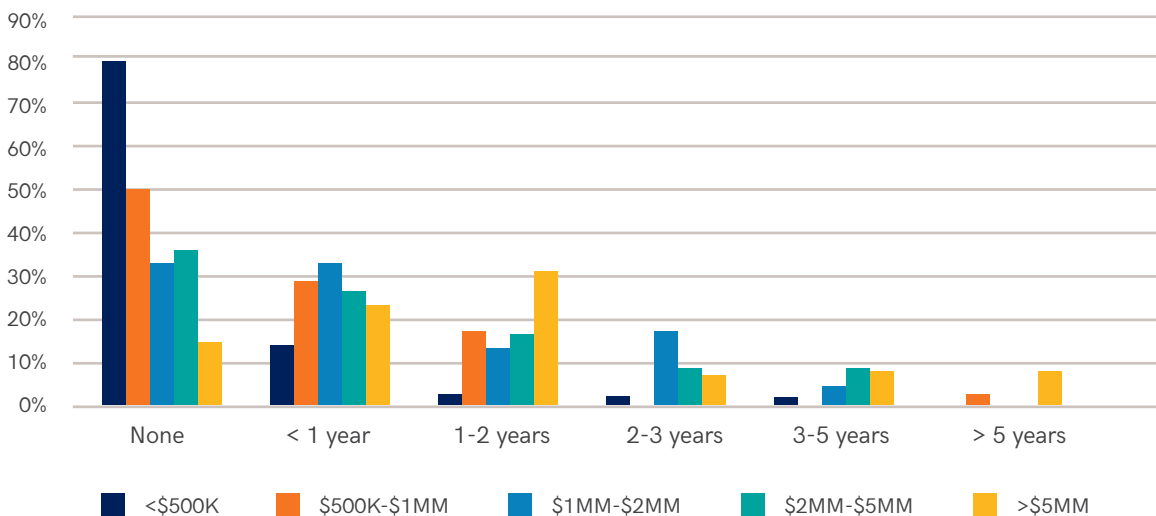


FIGURE 10: FEW BUSINESS OWNERS PLAN YEARS AHEAD



"Baby boomer business owners will spend more time planning their children's weddings than planning their exit strategy," said Lisa Riley, CBI, Principal of LINK Business-Phoenix. "That's unfortunate, because for many owners, their business is their largest asset and how they transition it will define their retirement lifestyle."

ABOUT PEPPERDINE GRAZIADIO BUSINESS SCHOOL

Anchored in the core values of integrity and innovation, the [Pepperdine Graziadio Business School](#) challenges individuals to think boldly and drive meaningful change that positively impacts their organizations and communities. With an entrepreneurial spirit, the Graziadio School advances experiential learning in small classes that deepen connections and stimulate critical thinking. Through our wide continuum of MBA, MS and Executive degree programs offered across six California campuses, Graziadio faculty inspire full time students and working professionals to realize their greatest potential as values-centered, “best for the world” leaders. Follow Pepperdine Graziadio on [Facebook](#), [Twitter](#), [Instagram](#), and [LinkedIn](#).

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 and Market Pulse Quarterly Report in cooperation with the International Business Brokers Association and M&A Source.

ABOUT INTERNATIONAL BUSINESS BROKERS ASSOCIATION

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.

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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. For more information about the M&A Source visit www.masource.org or follow The M&A Source on [Facebook](#), [LinkedIn](#), or [Twitter](#).



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