

Q1 2018



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

MARKETPULSE

QUARTERLY SURVEY

FIRST 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.

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The IBBA and M&A Source Market Pulse

SURVEY REPORT Q1 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 Q1 2018 survey was completed by 271 business brokers and M&A advisors. Respondents completed 257 transactions this quarter.

FIGURE 1: MARKET SEGMENTS STUDIED

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

CONFIDENCE STRONG IN EARLY 2018

Advisors continue to be bullish on a strong M&A market for 2018. In the Main Street and lower middle markets, 86% of advisors said business owner confidence was as good (25%) or better (61%) than a year ago.

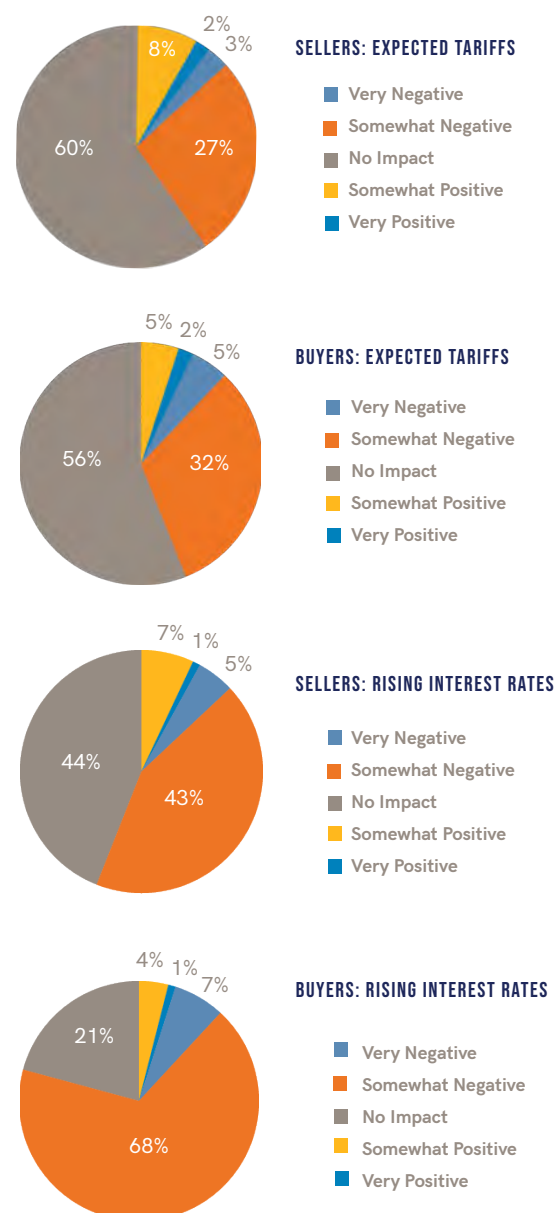
Advisors are optimistic about deal flow, with all sectors predicting an uptick in new client engagements. With a solid market and multiples at or near peak, advisors predict only slight room for value increases in the months ahead.

Optimism persists despite economic and political concerns around tariffs and interest rates. The majority of advisors believe that tariffs will have no impact on buyers (56%) and sellers (60%). Meanwhile, rising interest rates are viewed as relatively problematic, with advisors predicting a negative impact on sellers (43%) and buyers (68%).

Rising interest rates may spur activity in the short-term, as buyers are motivated to take on debt before financing becomes more expensive. As interest rates move up, purchase prices may be subdued, despite an otherwise strong market.

"The industry as a whole is keeping a close eye on the tariff situation. For now, it may be too soon to predict the impact on M&A", said Mike Camerota, JD, M&AMI, CM&AP, Founder of Touchstone Advisors, M&A Source Chair. "We expect better clarity as buyers and sellers reconcile tariffs with business costs. Many businesses are taking a 'wait and see' approach as current economic growth could make an increase in raw material pricing more tolerable."

FIGURE 2: EXPECTED IMPACT OF TARIFFS AND INTEREST RATES



WHO HAS THE ADVANTAGE: BUYERS OR SELLERS?

Consistent with general market optimism, advisors believe seller advantage is growing, with year-over-year seller-market sentiment increases in four market sectors. In the Main Street market, the \$1 million to \$2 million sector earns the biggest jump in confidence, growing 14%. Seller market sentiment is at an all-time high in four of five market sectors.

FIGURE 3: SELLERS MARKET SENTIMENT CLIMBING

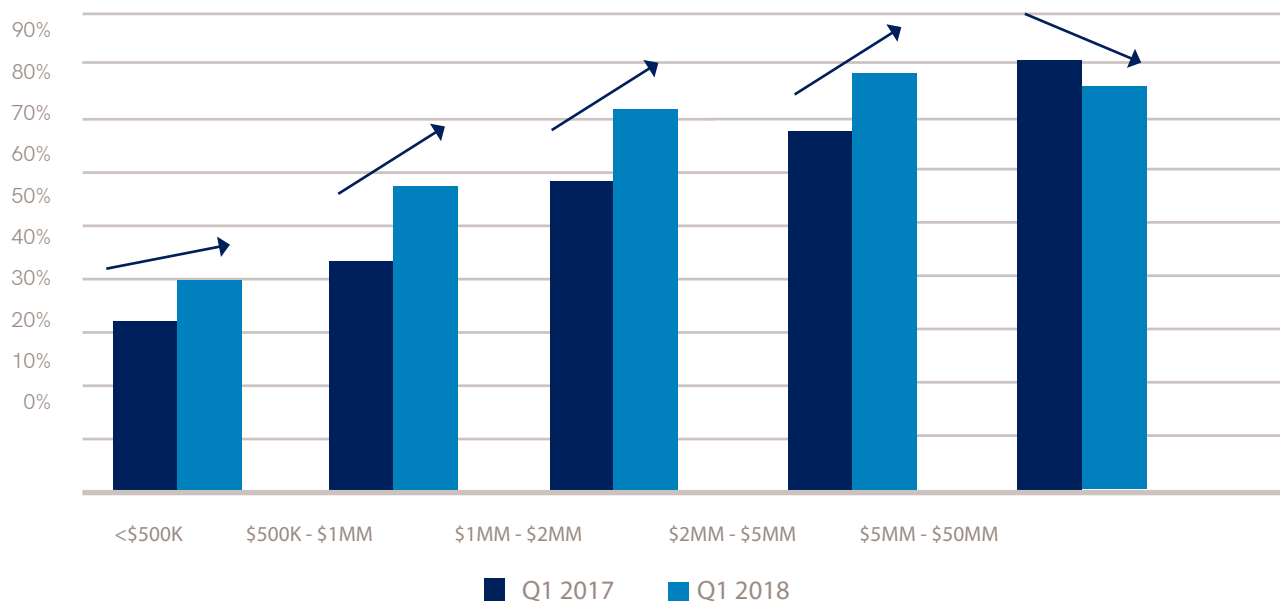
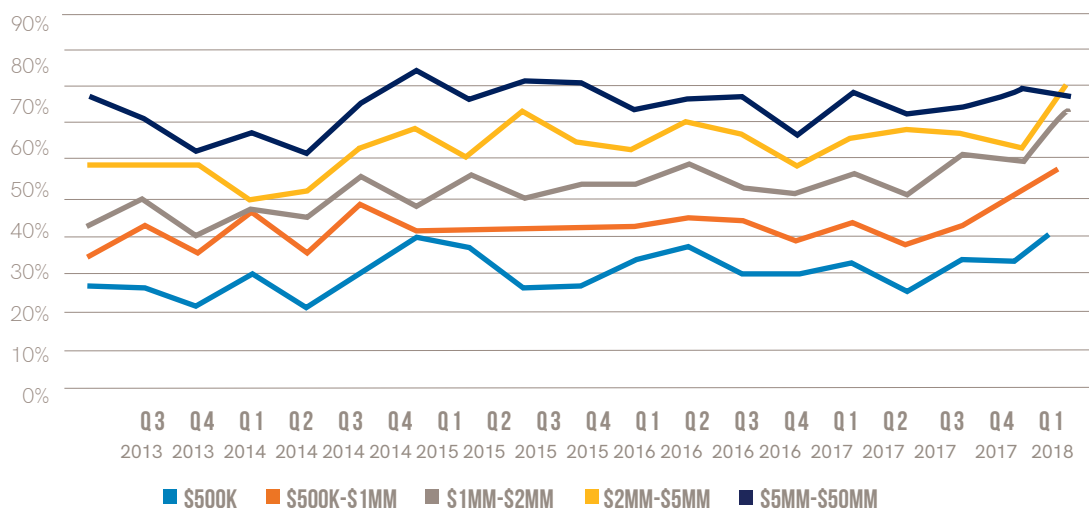


FIGURE 4: SELLER'S MARKET SENTIMENT, HISTORICAL TRENDS



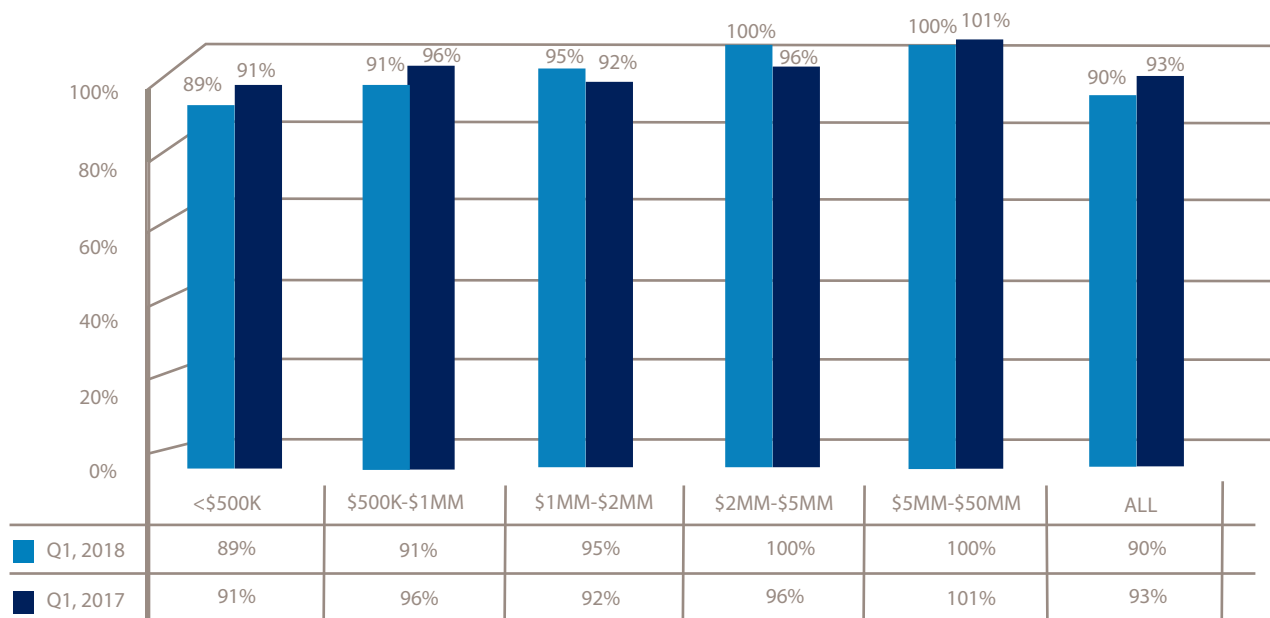
"A strong economic outlook and continuing market confidence enhances seller leverage," said John Howe, M&AMI, Director, Business Transition Strategies. "The stars are aligned right now for our sellers. There aren't enough quality opportunities to meet demands and buyers are paying a premium to beat their competition at the negotiation table."

WHERE ARE BUSINESS VALUES TRENDING?

In Q1, final sale prices came in anywhere from 89% to 100% of the pre-set asking price or internal benchmark. Lower middle market companies in the \$2 million to \$50 million range achieved the highest values at 100% of benchmark.

"As you move up in business value, there are fewer businesses available for sale but a proportionately larger amount of buyers who are pursuing these types of companies to acquire," said Thomas Whipple, M&AMI, CBI, Managing Principal of Falcon Advisors. "Supply and demand is driving up valuations."

FIGURE 5: FINAL PRICE REALIZED VERSUS ASKING PRICE



Multiples. Multiples continue to remain strong in all categories, with two sectors at or above peak. The largest market sector reached a median multiple of 6.1, a 0.3 increase above the previous sector peak of 5.8 seen in Q3 2016. This is a 35% increase over the Q1 2014 multiple, when the markets were still recovering from the recession.

FIGURE 6: MEDIAN MULTIPLE OFF PEAK

	2018	2017					2016				2015	2014
	Q1	Q4	Q3	Q2	Q1		Q4	Q3	Q2	Q1	Q1	Q1
MEDIAN MULTIPLE PAID (\$DE)												
<\$500K	2.0	2.0	2.0	2.0	2.3		2.3	2.3	2.3	2.0	2.0	2.0
\$500K-\$1MM	2.8	2.5	2.5	2.3	2.8		2.8	3.0	2.8	2.8	2.7	2.6
\$1MM-\$2MM	3.3	3.1	3.1	3.3	3.3		3.3	3.3	3.3	3.0	3.3	3.1
MEDIAN MULTIPLE PAID (EBITDA)												
\$2MM - \$5MM	4.4	4.3	4.5	4.3	5.3		4.8	4.5	4.0	4.0	4.5	4.3
\$5MM - \$50MM	6.1	5.5	5.0	5.4	5.3		5.5	5.8	5.1	5.5	4.9	4.5

"Timing the market absolutely has an effect on value, independent of company performance," said Warren Burkholder, CBI, President of NEVRG, Inc., IBBA Chair. "From political, to economic and global events, business owners have to realize that certain things are out of their control. Business value could jump or drop from one day to the next due to something that has nothing to do with how well you manage your company."

FIGURE 7: DEAL SIZE INCLUDES MOST COMMON MULTIPLE TYPE

DEAL SIZE	MOST COMMON MULTIPLE TYPE
\$500K	SDE w/o working captial
\$500K - \$1MM	SDE w/o working captial
\$1MM - \$2MM	SDE w/o working capital
\$2MM - \$5MM	SDE w/o working capital
\$5MM - \$50MM	EBITDA incl. working capital

*SDE Sellers Discretionary Earning
*EBITDA Earnings Before Interest, Taxes, Depreciation and Amortization

Time to Close. The average time to close is 8.7 months.

FIGURE 8: TIME TO CLOSE NORMALIZING ACROSS SECTORS

	Q1 2018		Q1 2017	
BUSINESS VALUE	MONTHS TO CLOSE	MONTHS FROM LOI TO CLOSE	MONTHS TO CLOSE	MONTHS FROM LOI TO CLOSE
<\$500K	7	2	7	2
\$500K - \$1MM	8	3	6	2
\$1MM - \$2MM	9	3	6	3
\$2MM - \$5MM	9.5	3	11	4
\$5MM - \$50MM	10	4	12	4

“With interest rate increases looming, buyers and sellers were motivated to accelerate the deal making process early this year. We may continue to see abbreviated timeframes in an effort to get ahead of additional increases,” said Craig Everett, PhD, Director of the Pepperdine Private Capital Markets Project. “At the same time, a strong seller’s sentiment in the lower middle market gives business owners and advisors the leverage they need to set timetables and keep the deal process moving forward.”



Cash at Close. Sellers are getting even more cash at close this quarter, matched with declining seller financing.

FIGURE 9: SELLER FINANCING DECLINES

	Q1 2018				Q1 2017			
	CASH AT CLOSE*	SELLER FINANCING	EARN OUT	RETAINED EQUITY	CASH AT CLOSE*	SELLER FINANCING	EARN OUT	RETAINED EQUITY
<\$500K	84%	12%		1%	77%	20%	2%	1%
\$500K - \$1MM	80%	11%	1%	1%	77%	18%	2%	1%
\$1MM - \$2MM	79%	11%	9%	1%	75%	19%	2%	
\$2MM - \$5MM	89%	11%	1%		82%	12%	2%	2%
\$5MM - \$50MM	82%	8%	2%	14%	64%	15%	3%	14%

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

"Above average cash at close for quarter one represents multiple things going on in the marketplace," said Lisa Riley, CBI, Principal of LINK Business-Phoenix. "We have well financed buyers at every size of deal, banks are lending at near record multiples, and confidence is high. When you factor in those three things, it allows sellers to take the vast majority of cash at close."

"But as you can see, even in peak times, sellers are still supporting deals with seller financing. A seller who refuses to accept those terms will almost certainly be leaving money on the table, if they sell at all," Riley continued.

WHY ARE OWNERS SELLING

Retirement continues to lead as the number one reason to sell across most sectors, followed by burnout.

FIGURE 10: TOP 2 REASONS SELLERS WENT TO MARKET

DEAL SIZE	#1 REASON	#2 REASON
<\$500K	Retirement 34 %	Burnout 24%
\$500K - \$1MM	Retirement 44%	Burnout 20%
\$1MM - \$2MM	Retirement 61%	New Opportunity 18%
\$2MM - \$5MM	Retirement 55%	(tie) Burnout, Family, Other 10%
\$5MM - \$50MM	Burnout 47%	Recapitalization 16%

MAIN STREET ISN'T PLANNING

The majority of Main Street business owners fail to plan for the sale of their business. Advisors indicated that 88% of business owners in the <\$500,000 sector conducted no formal planning prior to engagement. Lower middle market business owners were more proactive, although roughly 45% also failed to make advance plans to sell.

Even among business owners who do plan (Figure 11), 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 11: BUSINESS OWNERS WHO ENGAGED IN NO FORMAL PLANNING BEFORE ENGAGEMENT

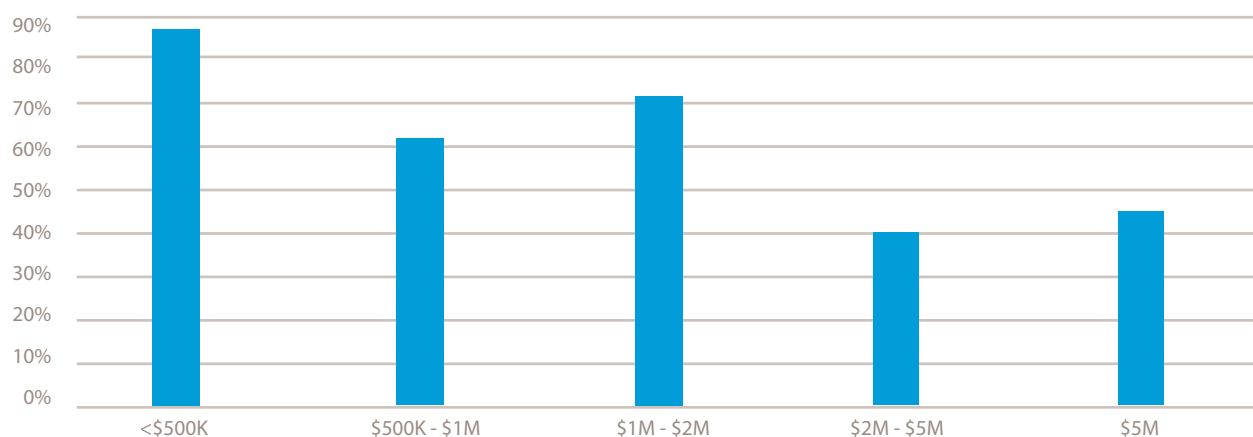
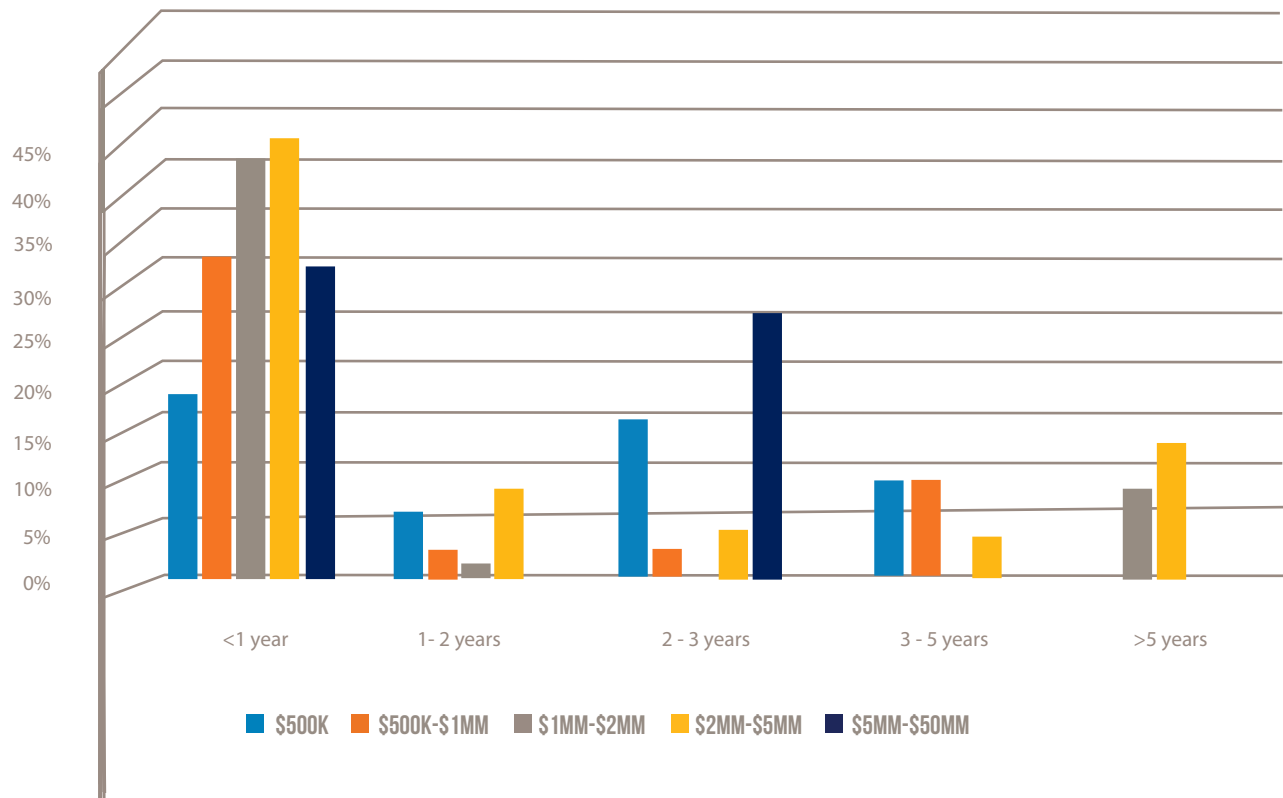


FIGURE 12: PERCENT OF THOSE WHO PLAN, FEW PLAN MORE THAN A YEAR



“The reality is that the more you plan for your exit, the better chance you have of selling and maximizing the value of all your hard work,” said Scott Bushkie, M&AMI, CBI, President of Cornerstone Business Services. “As we can see, more lower middle market firms did some planning, albeit limited, and those businesses received 100 percent of their expected value at time of sale.”

“Unfortunately, for whatever reason, business owners just do not plan. Selling a business takes planning, time, and money to do it right. It just doesn’t come together magically in the end,” said David Ryan, an advisor with Upton Financial Group in California. “And you don’t get to take a mulligan on this. If you try and fail to sell your business, there’s always a negative ripple effect in terms of lost focus, burnout, and confidentiality.”

“There’s an old saying,” Ryan continued. “Professionals have coaches. Amateurs don’t. If you take your business seriously and want to maximize value and minimize taxes, talk to a business broker or M&A advisor.”

“These results are right on track with other surveys that suggest roughly two-thirds of business owners fail to plan. Obviously, the problem is worse in the Main Street market where we’re looking at closer to three quarters,” Bushkie added.

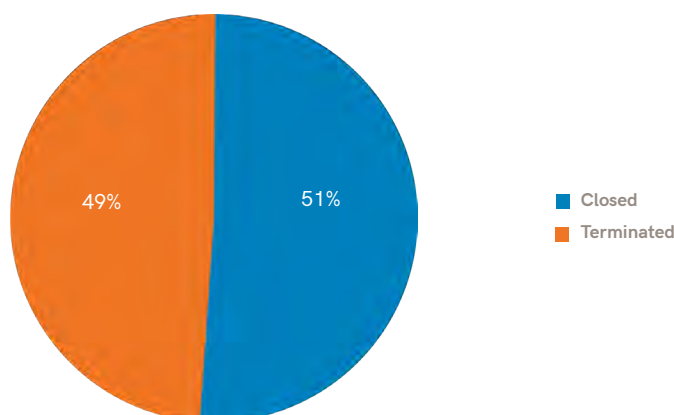
HALF OF BUSINESSES DIDN'T SELL

Advisors were asked to share what percentage of transactions terminated without closing in the last three months. They reported that nearly half (49%) of their transactions terminated without closing this quarter.

Leading reasons those deals failed to close:

- + Seller's unrealistic expectations (12%)
- + Buyer got cold feet (12%)
- + Buyer and seller couldn't agree on terms (10%)
- + Seller got cold feet (9%)
- + Offers came in below seller's expectations (8%)
- + Poor books and recordkeeping (6%)
- + No offers submitted (6%)
- + Books didn't match reported numbers (5%)
- + Financing fell apart (5%)
- + SBA fell apart/took too long (4%)
- + Buyer's lowball offer (3%)

FIGURE 13: HALF OF LISTINGS DIDN'T SELL



"As an industry, we know that the majority of closely held businesses that go to market do not end up selling. Competition is high for the quality businesses, but owners aren't doing enough to make their businesses attractive to buyers," said David Ryan, an advisor with Upton Financial Group in California. "We can see that helping a seller establish realistic market expectations and organized, vetted financial record keeping are two of the biggest ways we can get sellers across that finish line."

"Valuing a business is a specialized, complex process. Work with a credible advisor who will represent the market truthfully and give you the best chance to get your business sold," said Lou Vescio, CBI, M&AMI, Principal, Coastal Business Intermediaries, Inc. "Be wary of brokers or M&A firms making promises that feel too good to be true. Unfortunately, some firms out there make their living on large up-front retainers, not by selling the business. Look for people who have industry credentials like their CBI or M&AMI. These advisors invest a lot of time in ongoing education and have to maintain a certain code of ethics to be part of their industry association."

"Sellers who fail to plan are the same ones who go to market with unrealistic value expectations," explains Lisa Riley, CBI, Principal of LINK Business-Phoenix. "That's because exit planning forces you to confront the reality of what your business is worth. If you can't do that, you can't plan."

KNOW YOUR BUYER

<\$500,000: Buyers in this sector tend to be:

- + First time buyers (50%), serial entrepreneurs (31%), or existing companies (17%)
- + Motivated to buy a job (51%), gain a horizontal add-on (24%)
- + Located within 20 miles (66%) or 50 miles (17%) of the seller's location

<\$500K-\$1MM: Buyers in this sector tend to be:

- + Serial entrepreneurs (37%), first time buyers (32%), or existing companies (24%)
- + Motivated to buy a job (29%) gain a horizontal add-on (24%), or realize better ROI than other investments (22%)
- + Located within 20 miles (63%) or more than 100 miles (17%) of the seller's location

\$1MM-\$2MM: Buyers in this sector tend to be:

- + Existing companies (42%), serial entrepreneurs (27%), or first time buyers (24%)
- + Motivated to buy a job (42%) or gain a horizontal add-on (30%)
- + Located within 20 miles (40%), within 50 miles (17%), or within 100 miles (20%)

\$2MM-\$5MM: Buyers in this sector tend to be:

- + Existing companies (40%), first time buyers (25%), or serial entrepreneurs (20%)
- + Motivated to buy a job (40%), gain a horizontal add-on (30%), or realize better ROI than other investments (20%)
- + Located within 20 miles (35%), 50 miles (20%), or more than 100 miles (40%) of the seller's location

\$5MM-\$50MM: Buyers in this sector tend to be:

- + Existing companies (37%), PE firms seeking a platform acquisition (32%), or PE firms seeking an add-on acquisition (26%)
- + Motivated to acquire a horizontal acquisition (42%), vertical acquisition (32%), achieve better ROI (11%)



WHAT ARE THEY BUYING?

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

FIGURE 14: TOP INDUSTRIES BY MARKET SECTOR

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



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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 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. For more information about IBBA, visit the website at www.ibba.org or follow the IBBA on [Facebook](#), [Twitter](#), and [LinkedIn](#).

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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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