

Q2 2017



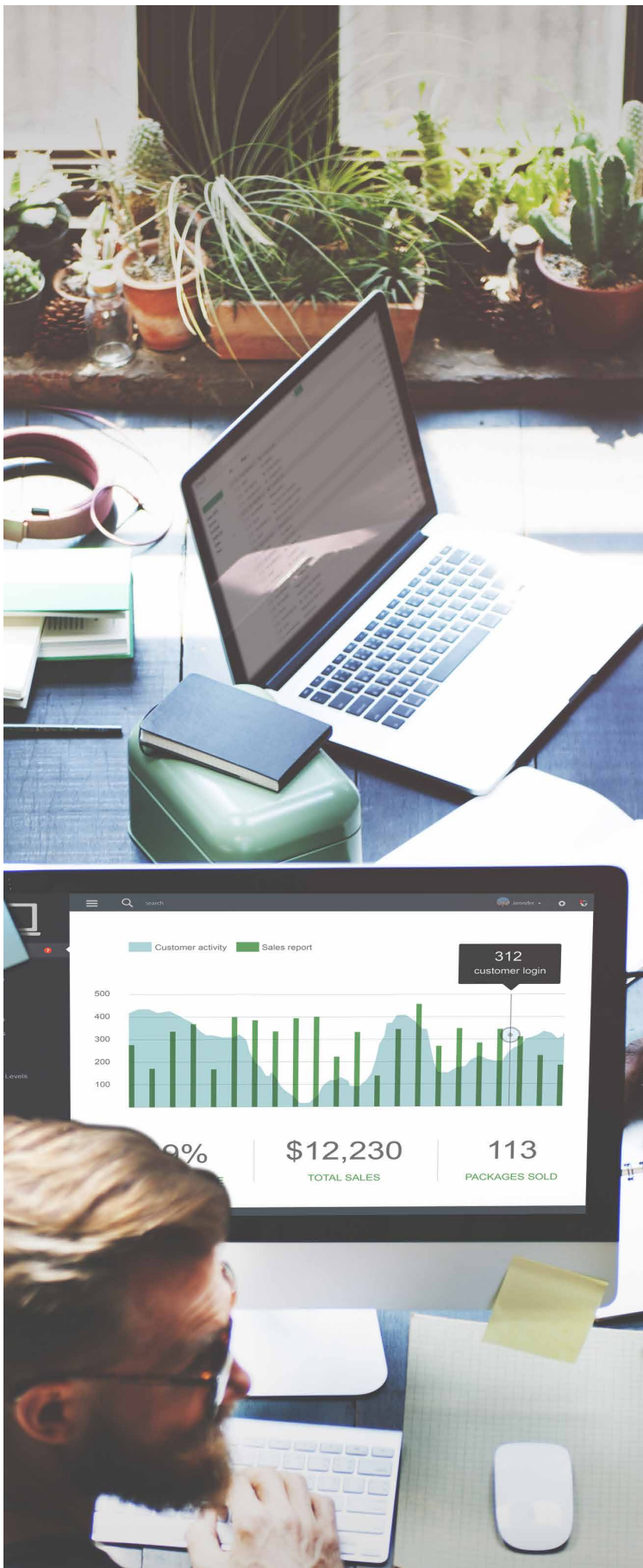
INTERNATIONAL BUSINESS BROKERS ASSOCIATION | M&A SOURCE | PEPPERDINE PRIVATE CAPITAL MARKETS PROJECT

MARKETPULSE

QUARTERLY SURVEY REPORT

SECOND QUARTER 2017





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 headquarters at admin@ibba.org or (888) 686-4222.

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THE IBBA AND M&A SOURCE MARKET PULSE SURVEY REPORT Q2 2017

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 Graziadio School of Business and Management at Pepperdine University.

The Q2 2017 survey was completed by 293 business brokers and M&A advisors, representing 38 states. Half of the respondents (51%) had at least 10 years of experience. Respondents completed 266 transactions this quarter.

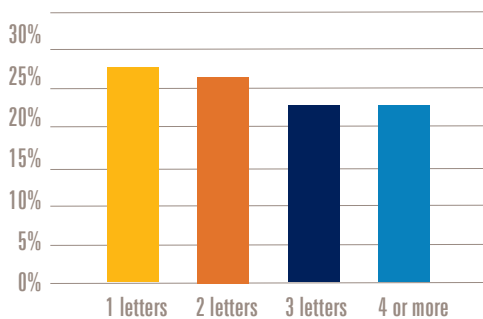
Figure 1: Market Segments Studied

Main Street	Lower Middle Market
Less than \$500K	\$2MM - \$5MM
\$500K - \$1MM	\$5MM - \$50MM
\$1MM - \$2MM	

LEVERAGE AND VALUATIONS

Seventy two percent of the participants received at least two letters of interests/offers on their most recent closing for their clients.

Figure 2: Multiple Indications of Interest

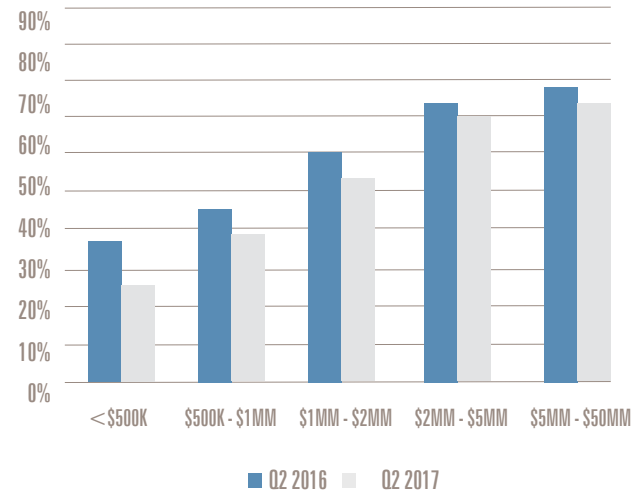


With multiple offers, were able to address clients' terms and conditions that were important to the business owners. Other than cash at close, advisors indicate that "overall terms" was the primary reason (42%) sellers choose one offer over another, followed by culture fit for employees (17%), complete exit for owner (13%), or faster time to close (11%).

"I sometimes say, 'One buyer is no buyer,'" said David Ryan, an advisor with Upton Financial Group in California. "By generating multiple letters of intent, you create the kind of leverage that gives a seller options. There's a lot to be negotiated in an offer. It's not all about the money. Financing terms, legacy issues, timing, and employee well-being can all play a role in which buyer makes it to the closing table. This leverage may be lost when a sales process is not run and the M&A advisor negotiates with only one buyer."

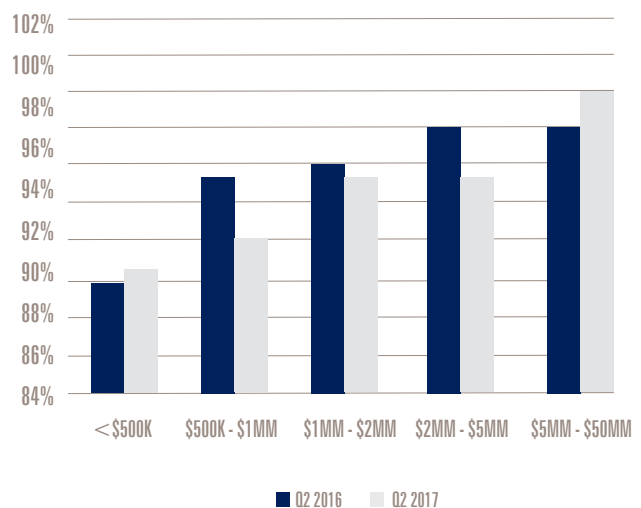
Even when receiving multiple letters of interest, advisors were less likely to report operating in a "seller's market" than they were a year ago. This is further evidenced when looking at year-over-year results, the final sale prices have fallen slightly in several sectors, when evaluated against the pre-set asking price or internal benchmark.

Figure 3: Seller's Market Sentiment Declining



"In Q2, a drop occurred in realized prices compared to the bench market price from a year ago in the 1 to 5 million valuation range. Taken along with a decline in the Intermediaries belief that it is a Seller's Market, this slight drop in such an important sector of our small business economy could be a reflection of the uncertainties in our horizon," explains Lisa Riley, CBI, Principal of LINK Business-Phoenix.

Figure 4: Final Price Realized vs. Asking Price



Multiples continue to remain strong in most categories, with declines in the smallest the Main Street segments. Year-over-year, multiples saw gains in both lower middle market segments.

Figure 5: Median Multiple

	2017		2016				2015			
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Median Multiple Paid (SDE)										
< \$500K	2.0	2.3	2.3	2.3	2.3	2.0	2	2	2	2
\$500K-\$1MM	2.3	2.8	2.8	3.0	2.8	2.8	2.5	2.5	2.5	2.7
\$1MM-\$2MM	3.3	3.3	3.3	3.3	3.3	3.0	3.3	2.8	3	3.3
Median Multiple Paid (EBITDA)										
\$2MM - \$5MM	4.3	5.3	4.8	4.5	4.0	4.0	4	4	4	4.5
\$5MM - \$50MM	5.4	5.3	5.5	5.8	5.1	5.5	5.1	5.3	5	4.9

Figure 6: Common Multiple Range Q2 2017

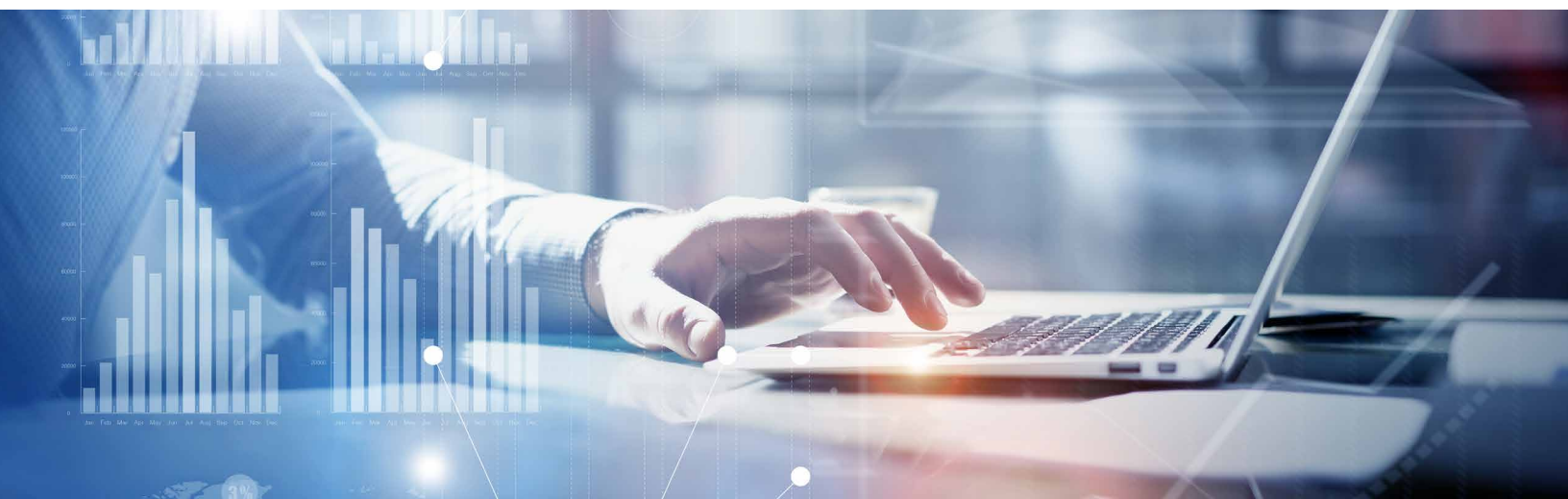
Common Multiple Range (SDE)	
< \$500K	58% between 1.75-2.5
\$500K - \$1MM	55% between 1.75-2.75
\$1MM - \$2MM	44% between 3.25-3.5
\$2MM - \$5MM	50% between 2.5-3.00
Common Multiple Range (EBITDA)	
\$2MM - \$5MM	54% between 4.0-4.5
\$5MM-\$50MM	77% between 4.25-7.0

Figure 7: 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 incl. working capital

* SDE Sellers Discretionary Earning

* EBITDA Earnings Before Interest, Taxes, Depreciation and Amortization



Compared year over year, time to close has remained relatively consistent, although advisors report faster progress in the lower middle market than they did in Q1 this year.

Figure 8: Time to Close

Business Value	Q2 2017		Q4 2016		Q3 2016	
	Months to Close	Months from LOI to Close	Months to Close	Months from LOI to Close	Months to Close	Months from LOI to Close
<\$500K	6	2	7	2	6	2
\$500K - \$1MM	6	2	6	2	6	3
\$1MM - \$2MM	7	3	6	3	9	4
\$2MM - \$5MM	9	3	11	4	9	4
\$5MM - \$50MM	9	5	12	4	9	4

“In quarter two, we see a return to normalcy in the pace that deals get done. Looking back at quarter one, we could be seeing the effects of the 2016 election season. With two very different candidates, leading to two very different business climates, buyers could have been waiting until the election was over to sign a letter of intent, and drawing out the timeline,” said *Scott Bushkie, CBI, M&AM, President of Cornerstone Business Services, Inc.*

In this quarter, owners got 71% or more cash at close. The majority of the balance came from seller financing, along with some earn outs.

Figure 9: Portion of Sale Received as Cash at Close

	Cash at Close*	Seller Financing	Earn Out	Retained Equity	Other
<\$500K	86%	12%	1%		
\$500K - \$1MM	81%	16%	3%		1%
\$1MM - \$2MM	71%	17%	7%	2%	2%
\$2MM - \$5MM	77%	14%	6%		
\$5MM - \$50MM	75%	10%	7%	3%	5%

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

“As usual, if the seller is expecting all cash at close, they could be in for a rude awakening,” said *John Howe, M&AM, Director, Business Transition Strategies, M&A Source Chair*. “Seller financing and earn outs help with transitions and bridge the valuation gap between what the seller wants and what the buyer is willing to pay. And from a buyer’s perspective, there’s nothing better than a big carrot like an earn out to ensure the seller is committed to your future success.”

In Q2 2017, retirement continues to lead as the number one reason to sell across all sectors, followed by burnout and new opportunities. Notably, advisors reported retirement and burnout were equal motivators in the \$1MM to \$2MM sector, marking this as the rare quarter in which retirement wasn't the absolute leading factor.

Figure 10: Top 2 Reasons Sellers Went to Market Q2

Deal Size	#1 Reason	#2 Reason	#3 Reason
<\$500K	Retirement	Burnout	New Opportunity
\$500K - \$1MM	Retirement	Burnout	(tie) New Opportunity/ Family
\$1MM - \$2MM	tie (Retirement/Burnout)		New Opportunity
\$2MM - \$5MM	Retirement	Other	Burnout
\$5MM - \$50MM	Retirement	Recapitalization	Other

“We know from experience that a proactive exit strategy yields much higher business values than exiting in burnout mode,” said *Lou Vescio, CBI, M&AMI, Principal, Coastal Business Intermediaries, Inc., IBBA Chair*. “Unfortunately, most buyers only really care about the last year or so of business performance, not what you did when you were full of energy and going strong. Waiting until you’re burned out is a common mistake, and business owners can lose anywhere from 20 to 50 percent of value by waiting too long.”

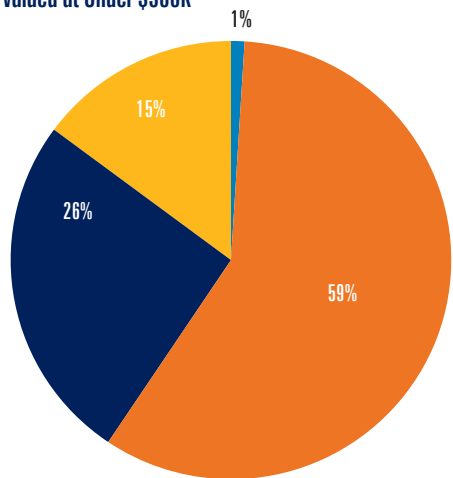
“Not only do sellers lose in the value game, but it’s a much more emotional, gut wrenching process to leave your business in a reactive, ‘not fun anymore, just get rid of it’s frame of mind,” Vescio continued. “It’s always better to plan ahead and go out on a high note.”

KNOW YOUR BUYER

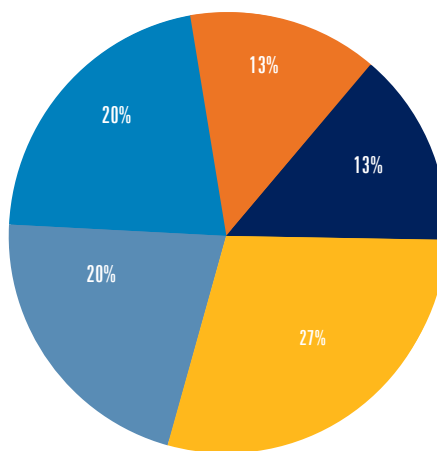
In the smallest deal category (businesses valued at <\$500K) first time buyers accounted for the largest buyer segment (59%). In the largest deal category (businesses valued between \$5 million to \$50 million) private equity made up the largest buyer group (40%) while individuals accounted for only 26% of buyers, half of whom were repeat business owners.

Figure 11: Buyer Comparison by Smallest/Largest Market Sectors

**Main Street
Businesses Valued at Under \$500K**



**Lower Middle Market
Businesses Valued at Greater Than \$5MM**



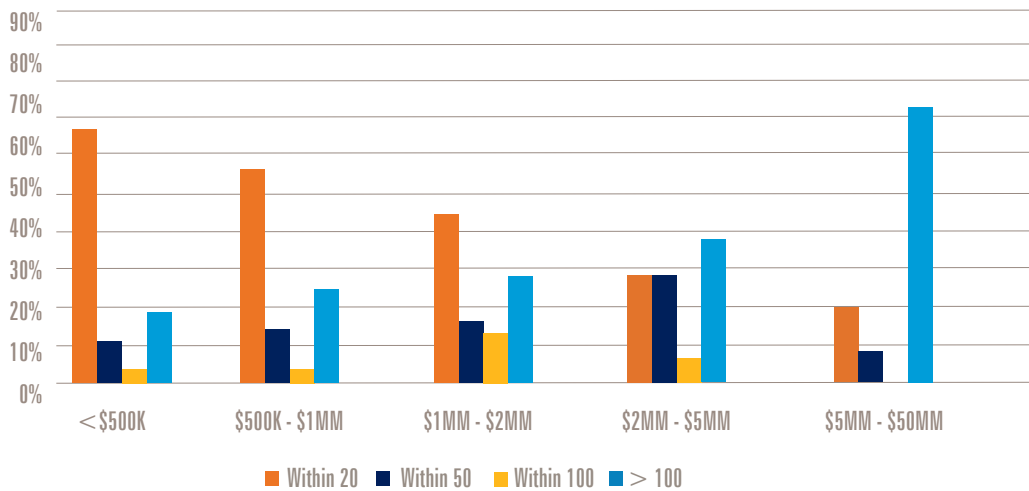
1st Time Experienced Owner Existing Business PE - Platform

1st Time Experienced Owner Existing Business PE - Platform PE - Add-on

WHERE DO THEY COME FROM?

Typically, buyers are sourced from a wider geographic area as deal size increases, and this quarter bore that out. As deal size increased, the market saw fewer successful buyers within 20 miles of the seller and more buyers located beyond a 100-mile radius.

Figure 12: Buyer Location (in miles - relative to seller)



“The old notion of calling your competitor down the street may work if you’re a small business, but the bigger your business, the less that strategy makes sense,” said *Kyle Griffith, CBI of Strategic Merger and Acquisition Advisors*. “It just reinforces the notion of working with an advisor who has the proper reach to market your company to the widest possible pool and bring more buyers to the table.”

WHAT MOTIVATES THEM?

Buyers in the Main Street market are most often motivated by a desire to buy a job. That is, the seller is looking to leave corporate America and be active full-time in the business. Buyers in the lower middle market are more often expanding an existing business through a horizontal or vertical add-on.

Figure 13: Buyer Motivation Shifts with Transaction Size

	Buying a Job	Growing via Acquisition/ Add-On	Better ROI than Other Investment
<\$500K	60%	22%	6%
\$500K - \$1MM	52%	27%	13%
\$1MM - \$2MM	24%	20%	28%
\$2MM - \$5MM	19%	47%	24%
\$5MM - \$50MM	13%	60%	27%

WHAT ARE THEY BUYING?

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

Figure 14: Top Industries by Market Sector

< \$500K	Personal Services	Restaurants	(tie) Business Services, Consumer Goods/Retails
\$500K - \$1MM	Business Services	Personal Services	Restaurants
\$1MM - \$2MM	Manufacturing	(tie) Consumer Goods/Retail, Personal Serv., Business Serv.	
\$2MM - \$5MM	Manufacturing	Construction/Engineering	(tie) Person Serv., Business Serv., Retail
\$5MM - \$50MM	Information Tech	Manufacturing	Healthcare & Biotech

“For years, people have talked about manufacturing being dead and jobs going overseas, but there is a resurgence in the U.S.,” said Craig Everett, PhD, director of the Pepperdine Private Capital Markets Project. “In the lower middle market, manufacturing is very much a sought-after industry, as it’s been the number one or two market leader for the last year or two. We see it every day: manufacturing businesses are busy, profitable, and in-demand.”



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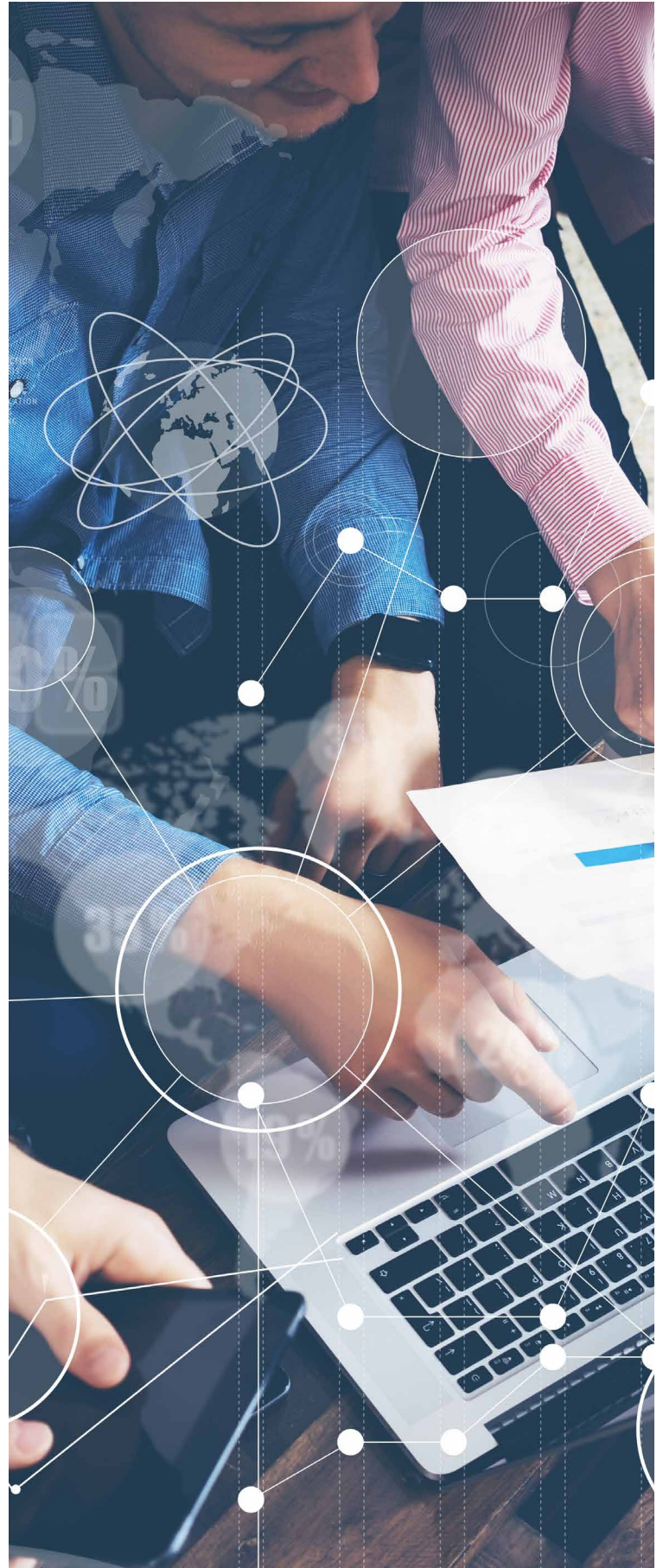
The Pepperdine Private Capital Markets Project reports on the current climate for privately held companies to access and raise capital, as well as the conditions influencing the decisions of lenders and providers serving small businesses and the lower middle market. Our ongoing research engages in multiple 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.

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