

Q3 2017



Currency		BID	
AUD	SGD	1.1017	1.1031
AUD	USD	0.8374	0.8379
EUR	USD	1.2368	1.2379
AUD	JPY	100.6300	100.7100
USD	JPY	120.1700	120.2100
AUD	CNY	5.1525	5.1560
USD	EUR	0.6765	0.6771
AUD	HKD	7.7513	7.7514
AUD	GBP	0.5351	0.5355
AUD	NZD	1.0784	1.0796

These quotes are delayed market rates sourced from Reuters.

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

MARKETPULSE

QUARTERLY SURVEY

THIRD 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.

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The IBBA and M&A Source Market Pulse

SURVEY REPORT Q3 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 Q3 2017 survey was completed by 334 business brokers and M&A advisors. About a third of the respondents (35 percent) 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	

According to labor statistics, the U.S. has added 16 million jobs since February 2010, and September 2017 hourly earnings increased 2.9 percent over the year. The labor market is tightening and unemployment rates remain at prerecession levels.

The challenge to find good talent could be good news for the M&A market. More than half (55 percent) of the business brokers and advisors surveyed expect the shrinking labor market will cause more business owners to expand through acquisition.

"Talent scarcity is driving M&A activity," said David Ryan, an advisor with Upton Financial Group in California. "For businesses looking to grow, acquisitions present an efficient way to land a trained and established labor force. When we talk to corporate M&A teams, we increasingly hear that talent acquisition is a key part of their strategy."

A tightening labor market could help spur the Fed to raise interest rates, with another rate increase anticipated this December. Nearly half (49 percent) of the advisors surveyed say the potential for rising interest rates has buyers and sellers pursuing aggressive timelines, hoping to get deals closed more quickly while financing is cheaper.

Meanwhile, most advisors (81 percent) say that uncertainty over Trump's tax plan is having little impact on M&A activity in the Main Street and lower middle market.

"We understand that tax uncertainty has hit the larger M&A market, as U.S.-targeted deals fell to their lowest rate since 2013," said Craig Everett, PhD, Director of the Pepperdine Private Capital Markets Project. "But here in the

Main Street and lower middle markets, sellers are maintaining a 'business as usual' approach when it comes to M&A tax issues."

"Nevertheless, Trump's efforts to reduce regulatory tax burdens have had a positive impact on some small and medium businesses," continued Everett. "The withdrawal of IRS Section 2704 means family business owners will still have access to some critical valuation discounts when transferring business shares to their kids. But essentially, the only real clarity we have right now is around taxes that support family succession plans, not outside M&A."

"If Trump's larger tax reforms go forward, we could see increased buyer demand as they have more available cash to execute deals," said John Howe, M&AMI, Director, Business Transition Strategies, M&A Source Chair. "If that happens, sellers may follow, provided they are keeping a pulse on valuation metrics. Unfortunately, sellers in this market segment aren't always proactive about working with the kind of advisor who will keep them updated on market trends."

On the other hand, more available capital might not increase deal flow.

"We're facing a shortage of high-quality acquisition targets in the lower middle market. Buyers already have the capital to spend, we just don't have the inventory to meet their needs," said Lou Vescio, CBI, M&AMI, Principal, Coastal Business Intermediaries, Inc., IBBA Chair.

In fact, advisors do not expect valuations to increase at all in the next three months. And while they report that incoming deal flow did not increase in Q3 2017, they hope for a modest uptick at year end.

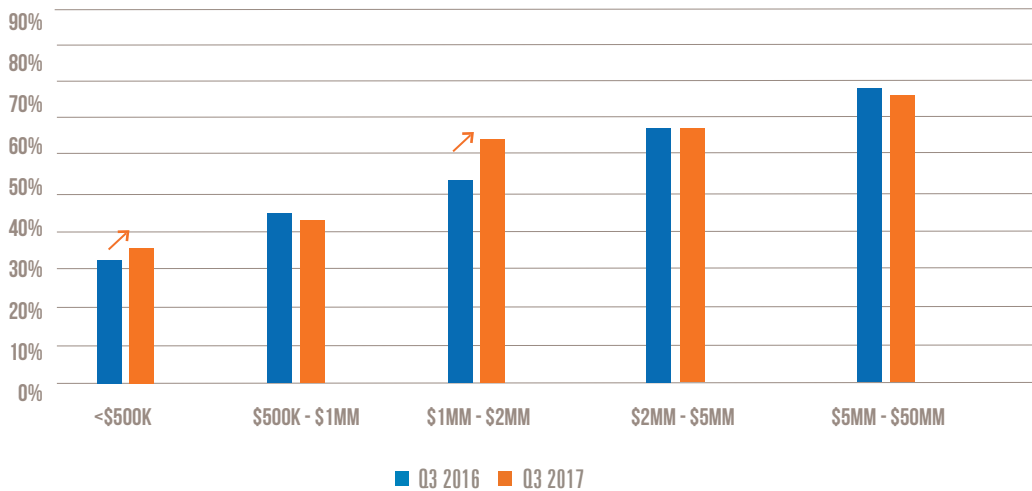
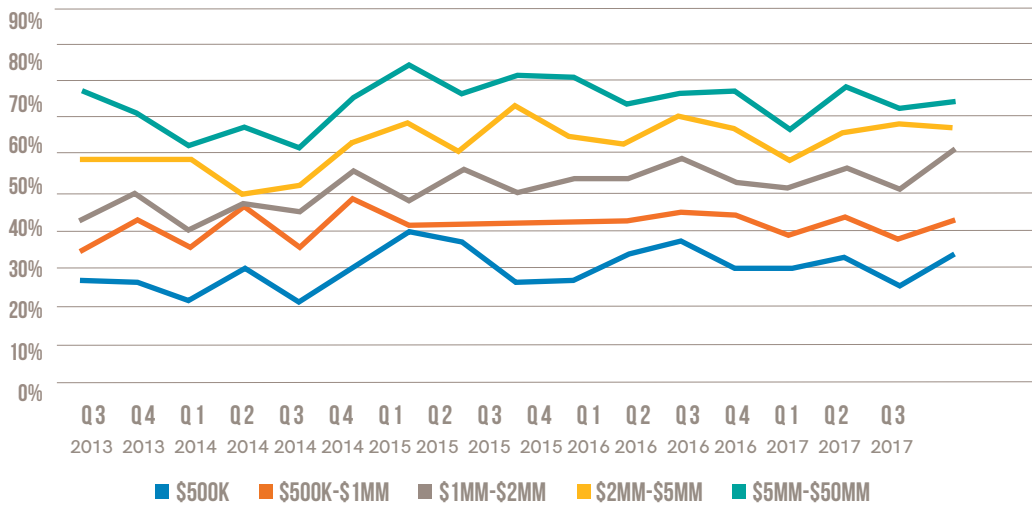
FIGURE 2: EXPECTATIONS MODEST

RECENT TRENDS AND EXPECTATIONS	MEAN SCORE (5-POINT SCALE)
Incoming deal flow	3.15
Expectation for new listings in next 3 months	3.50
Expectation for business valuations in next 3 months	3.07

*Mean score of 3 indicates no decline or growth (experienced or expected). Mean score averaged across all deal sectors.

FIGURE 3: SELLER'S MARKET SENTIMENT

Seller market sentiment is positive, reaching an all-time high in the \$1MM-\$2MM sector since the survey began in Q2 2012.



Year-over-year, multiples saw declines in most market segments. Nevertheless, multiples continue to remain strong. For sellers, valuations remain a compelling reason to enter the market. Meanwhile, buyers are no longer up against peak market prices, making it easier to justify an acquisition.

"Again, it is the opinion of the vast majority of deal makers that the market is going to get worse before it gets significantly better as business confidence reports indicate declines for the second consecutive quarter," said Carlos Guevara, CBI, VR Business Brokers San Antonio.

FIGURE 4: MEDIAN MULTIPLE

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

FIGURE 5: COMMON MULTIPLE RANGE Q3 2017

COMMON MULTIPLE RANGE (SDE)	
<\$500K	59% between 1.5-2.5
\$500K - \$1MM	68% between 2.0-3.0
\$1MM - \$2MM	50% between 3.0-3.25
\$2MM - \$5MM	42% between 3.0-3.25
COMMON MULTIPLE RANGE (EBITDA)	
\$2MM - \$5MM	59% between 3.5-4.5
\$5MM-\$50MM	60% between 4.0-5.5

FIGURE 6: MOST COMMON MULTIPLE TYPE BY DEAL SIZE

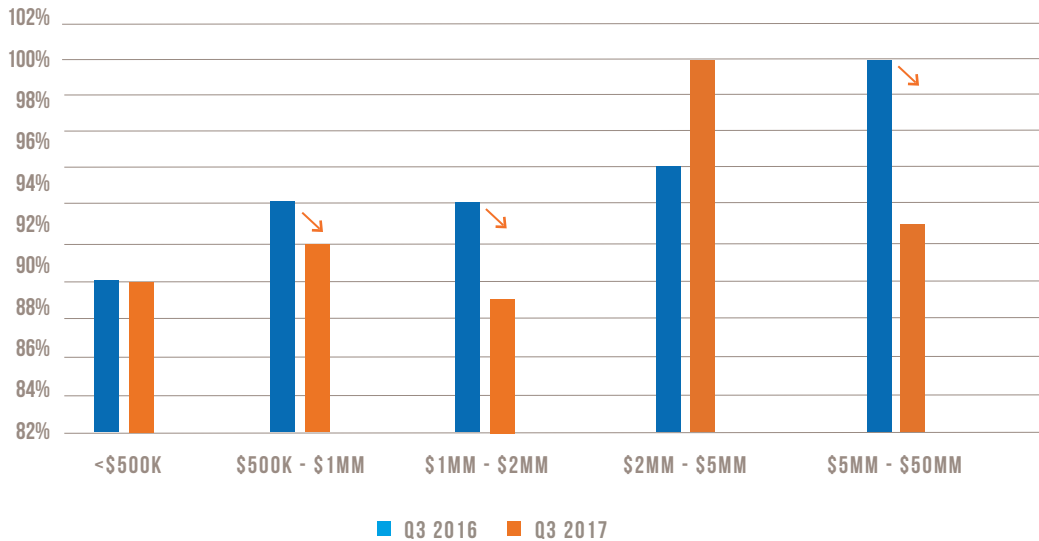
DEAL SIZE	MOST COMMON MULTIPLE TYPE
\$500K	SDE w/o working capital
\$500K - \$1MM	SDE w/o working capital
\$1MM - \$2MM	SDE w/o working capital
\$2MM - \$5MM	EBITDA incl. working capital
\$5MM - \$50MM	EBITDA incl. working capital

*SDE Sellers Discretionary Earning

*EBITDA Earnings Before Interest, Taxes, Depreciation and Amortization



FIGURE 7: FINAL PRICE REALIZED VS. ASKING PRICE



Year over year, time to close has shrunk in most sectors with progress accelerating significantly in the \$500K-\$1MM and the \$5MM-\$50MM sectors.

FIGURE 8: TIME TO CLOSE

BUSINESS VALUE	Q3 2017		Q2 2017		Q3 2016	
	MONTHS TO CLOSE	LOI TO CLOSE	MONTHS TO CLOSE	LOI TO CLOSE	MONTHS TO CLOSE	LOI TO CLOSE
<\$500K	6	2	6	2	7	2
\$500K - \$1MM	6.5	2	6	2	8	3
\$1MM - \$2MM	7.5	3	7	3	8	3
\$2MM - \$5MM	9	3	9	3	8	3
\$5MM - \$50MM	10.5	3.5	9	5	12	4.5

“Time frames may be lower due to sellers being more prepared and having a team that can help them move through the due diligence process more efficiently. The less prepared the seller and their team is the longer the process drags out and we all know the phrase, ‘Time Kills All Deals’ is all too true,” said Michael Fekkes, M&AMI, CBI, of Enligh Advisors.



In this quarter, owners received 71 percent or more cash at close. The majority of the balance came from seller financing, along with some earn outs to close the valuation gap. Trends remain relatively stable year-over-year.

FIGURE 9: PORTION OF SALE RECEIVED AS CASH AT CLOSE

	Q3 2017			Q3 2016		
	CASH AT CLOSE*	SELLER FINANCING	EARN OUT	CASH AT CLOSE*	SELLER FINANCING	EARN OUT
<\$500K	84%	12%	2%	83%	15%	1%
\$500K - \$1MM	83%	11%	1%	80%	17%	1%
\$1MM - \$2MM	71%	17%	7%	80%	12%	3%
\$2MM - \$5MM	86%	14%	1%	78%	12%	10%
\$5MM - \$50MM	73%	10%	4%	75%	8%	4%

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

In Q3 2017, retirement continues to lead as the number one reason to sell across all sectors, followed by burnout and new opportunities.

FIGURE 10: TOP 2 REASONS SELLERS WENT TO MARKET Q1

DEAL SIZE	#1 REASON	#2 REASON	#3 REASON
<\$500K	Retirement	New Opportunity	Burnout
\$500K - \$1MM	Retirement	Burnout	New Opportunity
\$1MM - \$2MM	Retirement	New Opportunity	Health
\$2MM - \$5MM	Retirement	Burnout	Family Issues
\$5MM - \$50MM	Retirement	(tie) Family Issues, Burnout	

"It can't be stressed enough how much better chance of success a business owner will have selling their business if they have the right team around them and proactively set an exit strategy and then execute on the plan versus reacting to a negative trigger in their business or personal life," said Scott Bushkie, M&AMI, CBI, President of Cornerstone Business Services.

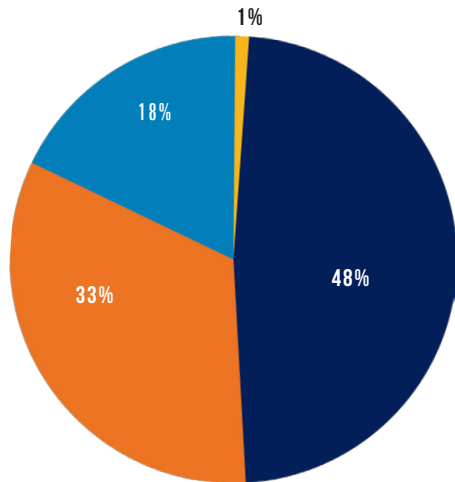


KNOW YOUR BUYER

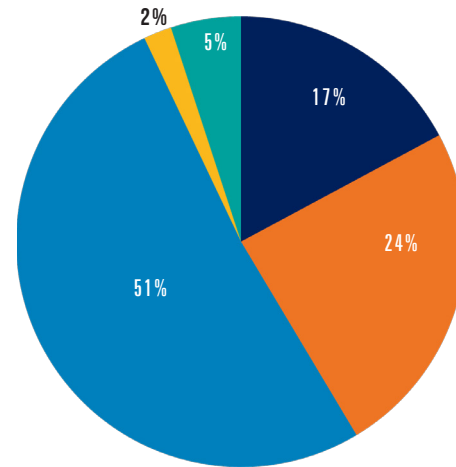
In the Main Street market, first time buyers accounted for the largest buyer segment (48 percent). Meanwhile, in the lower middle market, existing businesses accounted for 51 percent of buyers, followed by 24 percent experienced business owners.

FIGURE 11: BUYER COMPARISON BY SMALLEST/LARGEST MARKET SECTORS

MAIN STREET



LOWER MIDDLE MARKET



■ 1ST TIME INDIVIDUAL ■ INDIVIDUAL WHO OWNED BUSINESS
■ EXISTING COMPANY/STRATEGIC BUYER ■ PE FIRM - PLATFORM

■ 1ST TIME INDIVIDUAL ■ INDIVIDUAL WHO OWNED BUSINESS
■ EXISTING COMPANY/STRATEGIC BUYER ■ PE FIRM - PLATFORM ■ PE FIRM - ADD ON

"I think we're seeing significant activity from existing businesses for several reasons: We have a strong lending environment, corporate balance sheets are strong, and stock values are at record highs," said Mike Camerota, JD, M&AMI, of Touchstone Advisors. "It's an ideal time for companies to borrow."

WHAT MOTIVATES THEM?

Looking at buyer motivation reveals an uptick in activity by private equity and strategic corporate buyers, when compared to Q2.

FIGURE 13: BUYER MOTIVATION SHIFTS WITH TRANSACTION SIZE

	BUYING A JOB		GROWING VIA ACQUISITION/ADD-ON		BETTER ROI THAN OTHER INVESTMENT	
	Q3	Q2	Q3	Q2	Q3	Q2
<\$500K	52%	60%	26%	22%	7%	6%
\$500K - \$1MM	39%	52%	38%	27%	9%	13%
\$1MM - \$2MM	23%	24%	36%	20%	36%	28%
\$2MM - \$5MM	13%	19%	48%	47%	16%	24%

"Our economy is growing at just two percent. That, combined with the tight labor market, means organic growth is a real challenge right now," said Andrew Rogerson, M&AMI, CBI, Principal of Rogerson Business Services. "There's a strong demand for add-on acquisitions in the lower middle market."

WHAT ARE THEY BUYING?

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

FIGURE 14: TOP INDUSTRIES BY MARKET SECTOR

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

"Manufacturing companies are really hot right now. The manufacturers we've been taking to market are getting strong values," explains Lisa Riley, CBI, Principal of LINK Business-Phoenix. "Even manufacturers with significant issues like customer concentration are getting good looks, and it's a sign of how keyed in the market is to manufacturing right now."



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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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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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