

Q3 2018



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

MARKETPULSE

QUARTERLY SURVEY REPORT

THIRD 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 Q3 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 Q3 2018 survey was completed by 271 business brokers and M&A advisors. Respondents completed 237 transactions this quarter.

FIGURE 1: MARKET SEGMENTS STUDIED

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

THE STATE OF THE MARKET

High demand and low supply continue to make this a favorable seller's market. Buyers are active and competing against each other for quality deals, meaning sellers have choices when selecting their preferred buyer. This kind of leverage contributes to strong valuations and advantageous deal structures with more cash at close.

Several factors are driving the current market climate, including CEO confidence, healthy corporate balance sheets, record amounts of acquisition capital among both strategic buyers and private equity, and the continued relatively low cost of debt to finance deals. According to the NFIB, small business confidence is at a record high, with the longest stream of small business optimism in history.

In an exceedingly tight talent market, strategic buyers are looking to M&A to drive business growth. They're willing to pay a premium for quality businesses. These buyers continue to compete with

private equity firms, particularly in the lower middle market. With private equity fundraising continuing to surge, firms are shifting down market, targeting smaller acquisitions—but greater deal quantity—in order to put their capital to work.

Year-over-year, multiples were generally stable or increasing in most market segments. Looking back over the last five years, multiples remain near or above the historic average. In Q3 2018, in the lower middle market, sellers are walking away with more cash at close.

FIGURE 2: MARKET SKEWS IN SELLER FAVOR

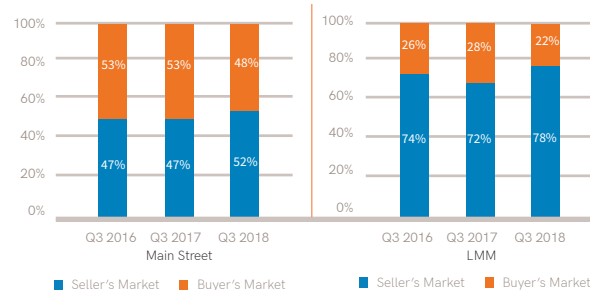
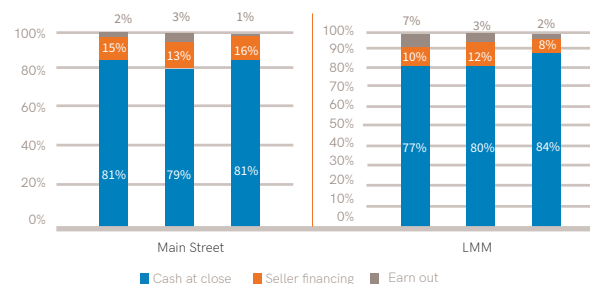


FIGURE 3: MEDIAN MULTIPLES STRONG

	2018			2017	AVG 2013-2018
	Q3	Q2	Q1	Q3	Q1
MEDIAN MULTIPLE PAID (SDE)					
<\$500K	2.0	2.0	2.0	2.0	2.05
\$500K-\$1MM	2.8	2.5	2.8	2.5	2.65
\$1MM-\$2MM	3.3	3.3	3.3	3.1	3.14
MEDIAN MULTIPLE PAID (EBITDA)					
\$2MM - \$5MM	4.0	3.8	4.4	4.5	4.28
\$5MM - \$50MM	5.4	5.9	6.1	5.0	5.3

FIGURE 4: CASH AT CLOSE INCREASED YEAR-OVER-YEAR



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

“Seller financing helps bridge the gap between what the buyers can, or are willing to pay, and what the seller wants for their business. In a seller’s market like this, we expect to see sellers getting more cash at close and carrying less risk on the purchase,” said Craig Everett, PhD, director of the Pepperdine Private Capital Markets Project.

“When the market yields high valuations, seller financing can remove obstacles to third party lending,” Everett continued.

“But sellers need to know that seller financing is almost always part of the deal, even when you have well-funded buyers competing to acquire your business,” Everett says. “Seller financing communicates a sense of confidence to the buyer and their lender that the seller is committed to the buyer’s continued success. Generally, buyers feel more comfortable when the seller keeps a little skin in the game.”

ADVISORS EXPECT A STABLE MARKET

In the Main Street market, 83% of advisors expect valuations will remain stable as we close out 2018. Advisors hold similar expectations for the lower middle market, with 78% predicting valuations will remain relatively stable over the next quarter. In terms of new deal flow, optimism is slightly tempered in Main Street. Advisors aren’t expecting a wave of new Boomer retirements to hit this market, and this should continue to play to the sellers’ advantage as demand outstrips available opportunities.

FIGURE 5: EXPECTATIONS FOR STABLE MARKET VALUATIONS

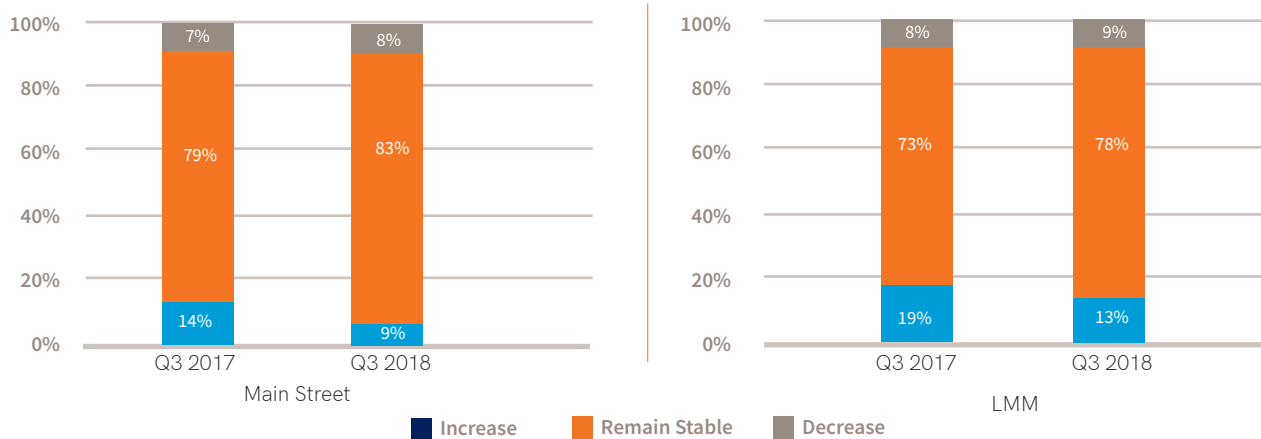
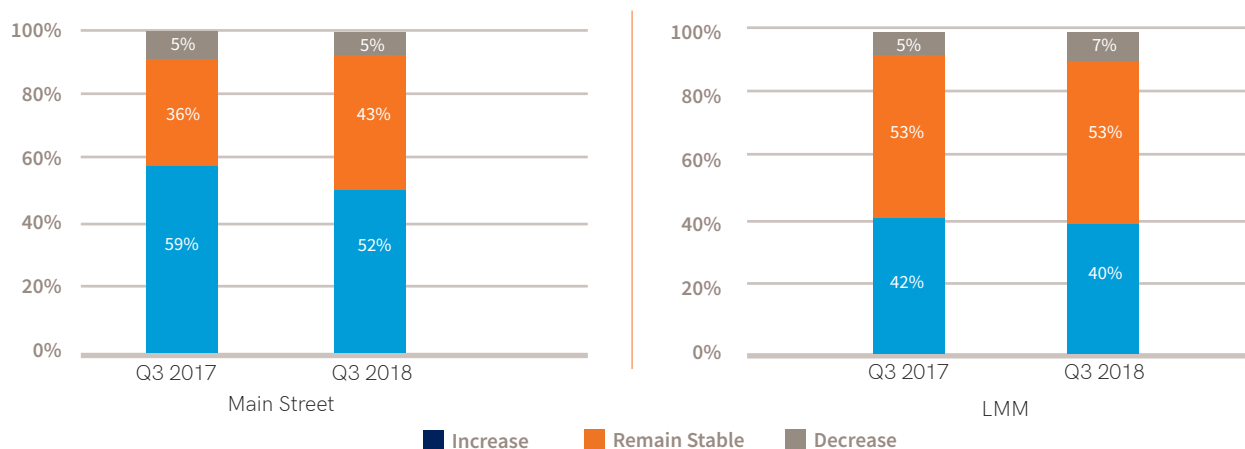


FIGURE 6: NEW DEAL FLOW EXPECTATIONS DOWN



“Many advisors, especially in the lower middle market, are trying to get as many sell-side clients through the pipeline as possible while demand is strong. A sense of reduced optimism could be attributed to the election process as sellers and buyers pump the breaks or sit in wait-and-see mode to see who gets elected,” said David Ryan, an advisor with Upton Financial Group in California.

SELLERS ARE NOT PREPARING FOR SUCCESS

Few sellers are taking the time to prepare themselves for the M&A process. According to advisors, 67% of sellers did no advance planning before putting their business on the market. Nearly a quarter (23%) did less than a year of planning.

Meanwhile, retirement continues to lead as the number one reason to sell across all sectors, followed by burnout and new opportunities. And, year-over-year, time to close has increased in most sectors.

FIGURE 7: MOST SELLERS DONT PLAN FOR SUCCESS

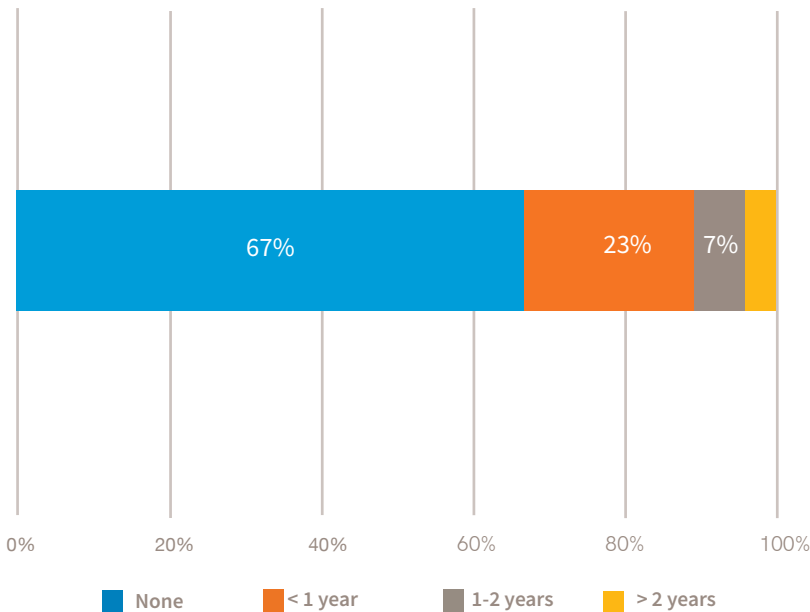


FIGURE 8: TIME TO CLOSE

BUSINESS VALUE	Q3 2018		Q3 2017	
	MONTHS TO CLOSE	LOI TO CLOSE	MONTHS TO CLOSE	LOI TO CLOSE
<\$500K	7	2	6	2
\$500K - \$1MM	8	3	6.6	2
\$1MM - \$2MM	9	3	7.5	3
\$2MM - \$5MM	9	3	9	3
\$5MM - \$50MM	10	3	10.5	3.5

FIGURE 9: TOP REASONS SELLERS WENT TO MARKET

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

"Sellers need to understand it takes about 7-10 months, depending on deal size, to close a transaction. That means even sellers who sign an engagement now won't be closing their deals until late summer or fall of 2019. We can't predict where the market will be at that point," said Lisa Riley, CBI, principal of LINK Business-Phoenix.

"The best things sellers can do is to start the process years in advance," said Kyle Griffith, managing partner, The NYBB Group. "To exit your business on your terms and monetize it for the most profit, you need advance planning."

CHOOSING THE RIGHT ADVISOR

Dating back to the earliest Market Pulse surveys in 2012, surveyed advisors consistently report that approximately 49-50% of their engagements closed in a successful transition while half are terminated. This closing ratio is approximately twice the accepted industry standard of anywhere from 18% to 30%, depending on deal size. Higher value businesses are more likely to sell.

This suggests that working with an IBBA or M&A Source advisor—professionals who reinvest in continuing education and industry networking—roughly doubles your chance of selling your business.

More than half the advisors surveyed had at least 10 years of M&A experience. Seasoned expertise also makes a difference as proven advisors are able to make deals happen and weather market downturns.

Beyond a successful closing rate, surveyed advisors are generating sale prices at or near expectations. In Q3 2018, Main Street sellers received 89% of the asking price while lower middle market sellers earned 99% of the pre-set benchmark.

"Knowledgeable advisors understand what the market will bear and won't set their clients up with false expectations," said Scott Bushkie, president of Cornerstone Business Services. "As an owner, you may not like what you hear from an educated broker, but you will get a credible estimate so you can make an informed decision on when to go to market."

FIGURE 10: 49% SUCCESS RATE EXCEEDS INDUSTRY BENCHMARKS

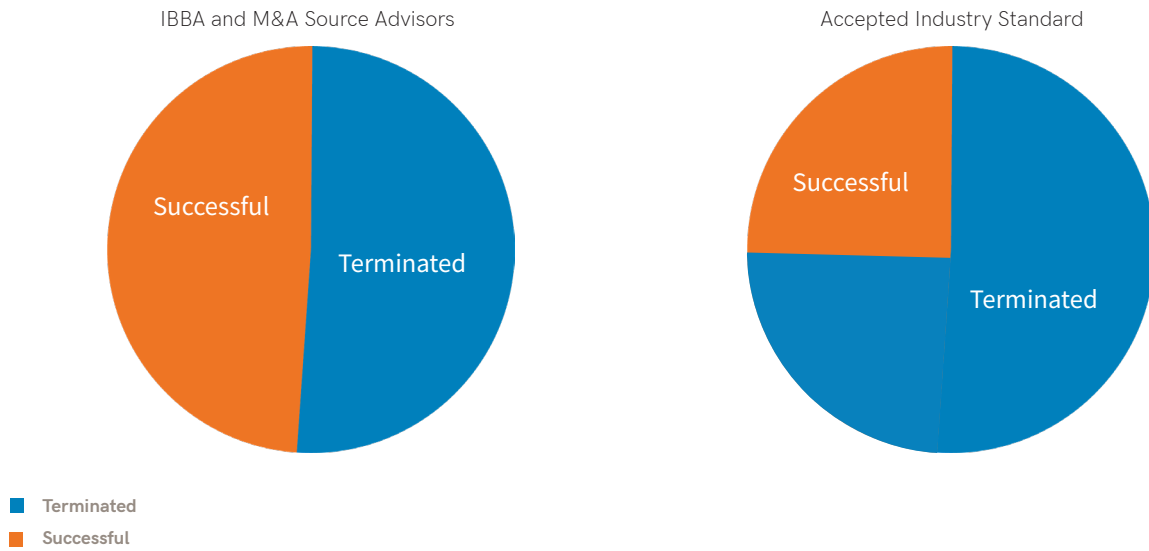
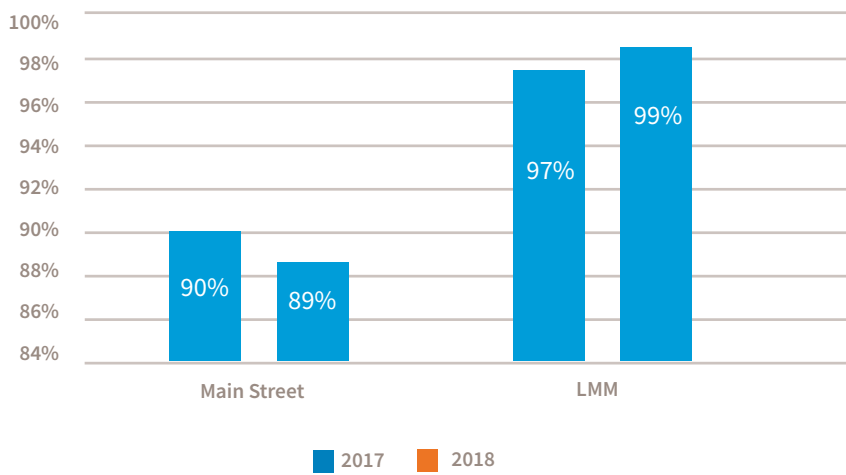


FIGURE 11: FINAL SELLING PRICE REALIZED TO ASKING/BENCHMARK PRICE



KNOW YOUR BUYER

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

- + First time buyers (50%), serial entrepreneurs (36%), or existing companies (13%)
- + Motivated to buy a job (50%), gain an add-on (31%)
- + Located within 20 miles (68%) or 50 miles (12%) of the seller's location

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

- + Serial entrepreneurs (42%), first time buyers (33%), or existing companies (23%)
- + Motivated to buy a job (39%) gain an add-on (34%),
- + Located within 20 miles (70%) or 50 miles (14%) of the seller's location

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

- + Existing companies (32%), serial entrepreneurs (29%), or first time buyers (32%)
- + Motivated to buy a job (32%) or realize better ROI than other investments (32%)
- + Located within 20 miles (52%) or more than 100 miles (32%) of the seller's location

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

- + Existing companies (30%), first time buyers (26%), or serial entrepreneurs (37%)
- + Motivated to gain an add-on (38%), or realize better ROI than other investments (30%)
- + Located within 20 miles (48%) or more than 100 miles (37%) of the seller's location

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

- + Private equity firms (53%), existing companies (20%)
- + Motivated to gain an add-on (53%), other (19%)
- + Located within 20 miles (20%) or more than 100 miles (60%) of the seller's location

WHAT ARE THEY BUYING

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

FIGURE 12: TOP INDUSTRIES BY MARKET SECTOR

\$500K	Restaurants	Personal Services	(tie) Business Services, Consumer Goods
\$500K - \$1MM	Construction / Eng.	Restaurants	(tie) Business Services, Personal Services
\$1MM - \$2MM	Business Services	(tie) Manufacturing, Personal Services, Consumer Goods	
\$2MM - \$5MM	Manufacturing	Construction / Eng.	Consumer Goods
\$5MM - \$50MM	Construction / Eng.	Business Services	(other)

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

ABOUT THE M&A SOURCE

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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