

Q1 2019



MARKETPULSE

INTERNATIONAL BUSINESS BROKERS ASSOCIATION | M&A SOURCE | FIRST QUARTER 2019 SURVEY





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 2019

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 2019 survey was conducted from April 1-15, 2019 and was completed by 292 business brokers and M&A advisors. Respondents completed 257 transactions this quarter. This is the 28th edition of this quarterly report.

FIGURE 1: MARKET SEGMENTS STUDIED

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

Will it sell?

Not every business will sell and a significant number never make it to market because professional, ethical advisors won't take on an engagement with little to no chance of success. The Q1 2019 Market Pulse Survey reveals that, on average, advisors decline about 70% of the business opportunities that come their way because the business is considered "non-saleable."

"There are any number of reasons we might decline to take a business to market," said Lisa Riley, principal of LINK Business-Phoenix. "Unrealistic expectations, meaning sellers place too high a value on their business, is typically the number one deal killer. Declining sales trends, dated business practices, over-reliance on the owner,

and significant customer concentration issues can all impact your ability to sell."

"As advisors, it's our obligation to tell people what they need to hear, not what they want to hear," said Scott Bushkie, managing partner of Cornerstone Business Services. "The further ahead you plan, the more we can help you overcome certain issues that would be red flags for buyers. But when business owners hang on too long, or come to the table burned out, then we might have to start talking about a distressed business sale or no sale at all."

Even when advisors do accept a business engagement, nearly half of those engagements will terminate before a successful closing. This finding has been relatively consistent across the survey's seven-year history.

"Deals fall through when offers come in below expectations, when buyers and sellers can't agree on terms, and—a lot of times—because one party or the other got cold feet," Riley continued. "You'll hear it in our industry again and again: 'Time kills all deals.' You need to come to market with well-organized records, realistic expectations, and a committed team who will keep the process moving forward. Anything less can lead to disappointment and ultimately hurt your ability to sell at all."

At the same time, most Main Street advisors report turning away anywhere from 1 to 10 would-be buyers or potential suitors, per engagement, because they are not qualified for the opportunities they pursue. Notably, 7% of advisors said they get more than 25 unqualified inquiries per engagement.

"Vetting buyers is a big part of what we do. It's just one of the ways we protect your confidentiality and how we keep the sale process from becoming a distraction to owners running their businesses," continued Bushkie. "Your advisors are there to make sure that no one gets your business information, or takes up your time, unless they are financially capable and sincerely motivated to make an acquisition."

70%

of businesses are considered non-saleable

48%

of businesses on the market won't sell

25

unqualified inquiries per engagement

Main Street isn't planning

The majority of Main Street business owners fail to plan for the sale of their business. Advisors indicated that 90% of business owners with enterprise value of less than \$500,000 conducted no formal planning prior to engagement. Lower middle market business owners were more proactive, although roughly 48% also failed to make advance plans to sell.

Even among business owners who do plan (Figure 2), only a few are working with any kind of professional advisor (e.g. CPA, wealth, attorney, M&A advisor, business broker) to discuss exit strategies a year or more in advance.

FIGURE 2: BUSINESS OWNERS WHO ENGAGED IN NO FORMAL PLANNING BEFORE ENGAGEMENT

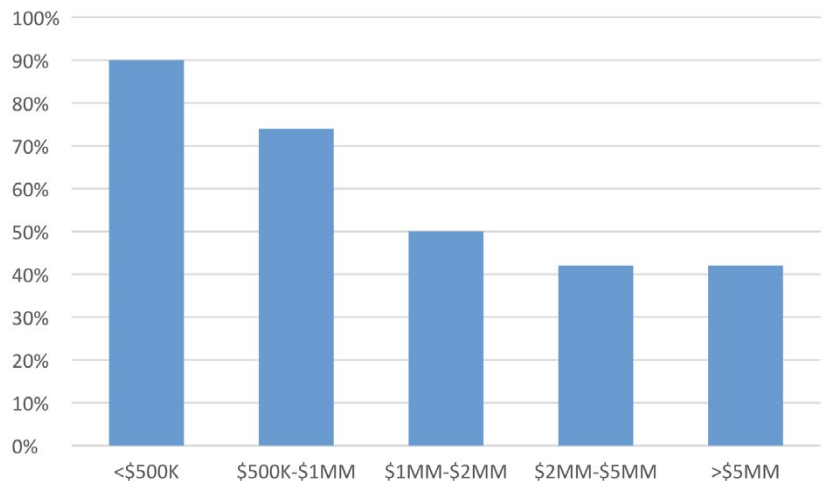
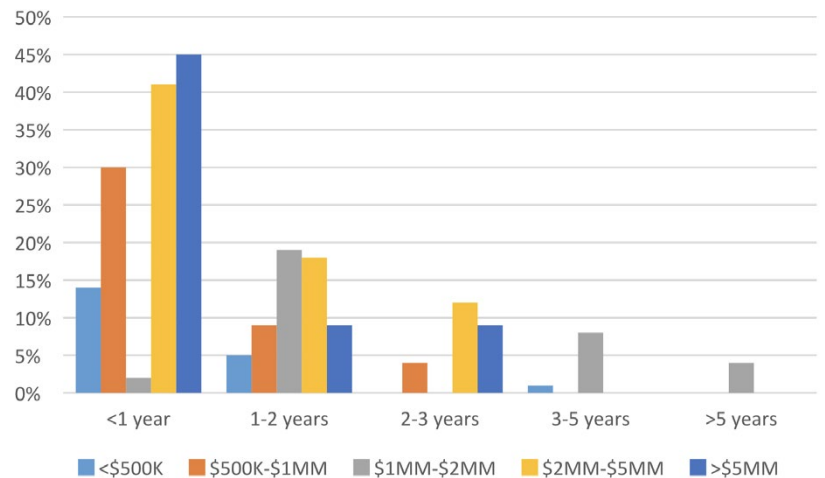


FIGURE 3: FEW BUSINESS OWNERS PLAN EVEN ONE YEAR AHEAD



“Selling a business requires planning and most business owners underestimate the experience required and time and effort involved,” said Jeff Snell, principal of Enlign Advisors. “Before going to market, sellers should ensure the business is in the best shape possible to receive the highest market value.”

“Regardless of who the buyer ends up being, there are things business owners can do to maximize the attractiveness of the business to buyers and decrease the amount of time required to sell,” Snell continued.

“Even if you think you’re going to pass the business on to your kids, you should have an exit plan that prepares the business for sale. That way, if you find out your children don’t really want it, you’re still in a good place to exit and get full value for your business,” said John Howe, M&AMI, director, Business Transition Strategies. “Your kids might rather have financial support to do something else they’re passionate about (Having those frank, potentially difficult conversations is part of the process).”

“Most business owners only know about 50% of the actual ways they can exit their business,” Howe continued. “We encourage business owners to be fully informed of their options, so everyone knows the choices on the table.”

“Most business owners only know about 50% of the actual ways they can exit their business.”

FIGURE 4: TIME TO CLOSE NORMALIZING ACROSS SECTORS

	Q1 2019		Q1 2018	
	MONTHS TO CLOSE	MONTHS FROM LOI TO CLOSE	MONTHS TO CLOSE	MONTHS FROM LOI TO CLOSE
<\$500K	8	2	7	2
\$500K - \$1MM	8	3	8	3
\$1MM - \$2MM	8	3	9	3
\$2MM - \$5MM	9	3	9.5	3
\$5MM - \$50MM	11	4	10	4

8.8

months is the average time to close

Who has the advantage: buyers or sellers?

Advisors believe that sellers hold the advantage in all market segments except the smallest. Year-over-year, however, shows a slight decline in confidence across all sectors except for businesses with \$5 million to \$50 million in enterprise value.

FIGURE 5: SELLER'S MARKET SENTIMENT

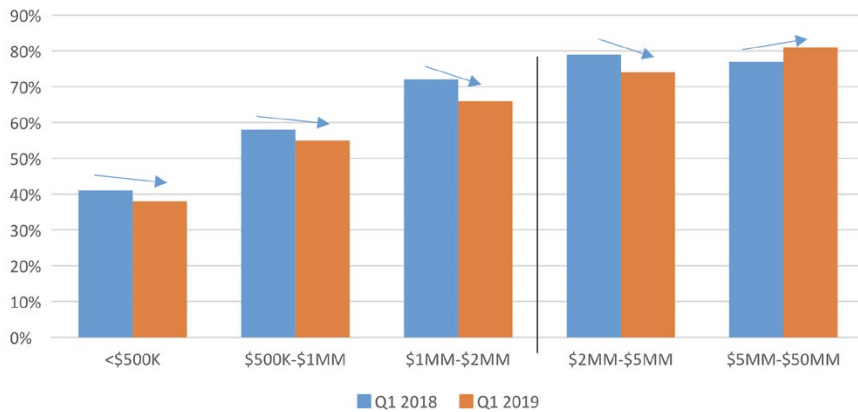
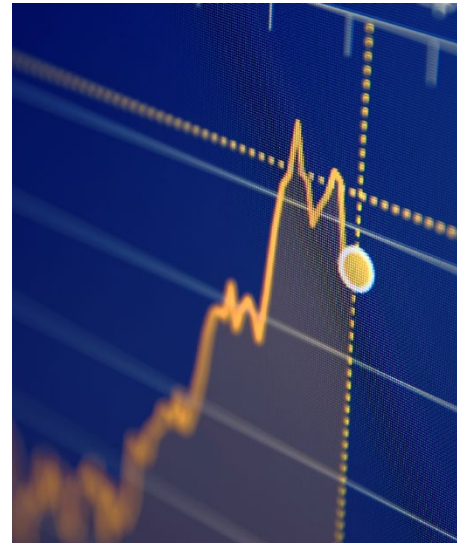
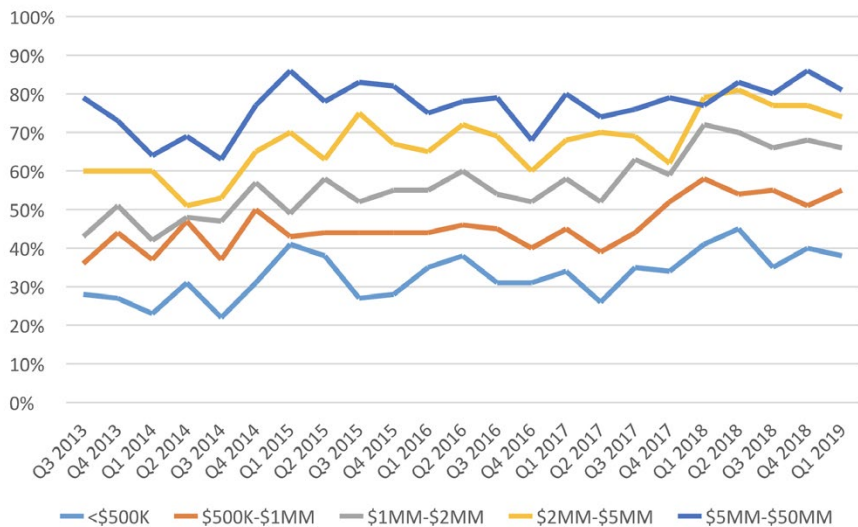


FIGURE 6: SELLER MARKET SENTIMENT, HISTORICAL TRENDS



“Although it is still a strong seller’s market with strong values, this is the first time in years that we’ve seen four out of five sectors report a dip in seller market sentiment,” said Craig Everett, PhD, director of the Pepperdine Private Capital Markets Project. “This is a sign the market has peaked, and more people are expecting a correction in the year or two ahead.”

“For those sellers who are having an emotionally hard time letting go, it’s most likely go now or wait another five to seven years before the market will cycle back up to current conditions,” Everett continued. “To be clear, this doesn’t mean you won’t be able to sell your business over the next five years, but you probably won’t get the multiples you can get today. Any market pessimism or uncertainty will drive down value across the board.”

Where are business values trending?

In Q1, final sale prices came in anywhere from 85% to 101% of the pre-set asking price or internal benchmark. Lower middle market companies in the \$5 million to \$50 million range achieved the highest values at 101% of benchmark.

"Businesses with enterprise value of \$5 million or more are most in demand right now. The market is not cooling at all for those sellers," said Gary Papay, managing partner of IBG Business. "That's reflected in supply-demand sentiment and multiples."

"Typically, businesses with values of \$5 million or more do not have an asking price. So those businesses have a better possibility of achieving values above the internal benchmark," Papay continued.

FIGURE 7: FINAL PRICE REALIZED VS. ASKING PRICE, Q1 2017-2019

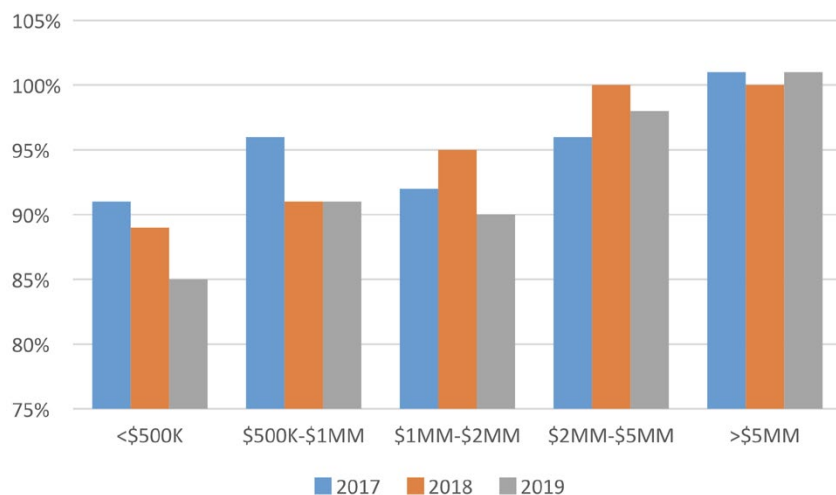


FIGURE 8: MEDIAN MULTIPLE OFF PEAK

	Q1 2019	Q1 2018	Q1 2017	Q1 2016	Q1 2015	Q1 2014
Median Multiple Paid (SDE)						
<\$500K	2.0	2.0	2.3	2.0	2.0	2.0
\$500K - \$1MM	2.5	2.8	2.8	2.8	2.7	2.6
\$1MM - \$2MM	3.0	3.3	3.3	3.0	3.3	3.1
Median Multiple Paid (EBITDA)						
\$2MM - \$5MM	4.3	4.4	5.3	4.0	4.5	4.3
\$5MM - \$50MM	6.0	6.1	5.3	5.5	4.9	4.5

Multiples

Multiples continue to remain strong in all categories, although no sector came in at or above peak. The largest market sector reached a median multiple of 6.0, just shy of Q1 last year.

Over the last six years, multiples in Main Street have varied within about a 10% range. However, the lower middle market has variations of 2.5 times that, or roughly 25%.

"Looking at the multiples, we can see that below the \$5 million mark they stay fairly consistent within a much tighter range," said David Ryan, advisor with Upton Financial Group. "However, the larger companies that go to market without a set asking price have a greater opportunity to achieve higher multiples, particularly as these businesses are more apt to be purchased by private equity or an existing company with synergies."

FIGURE 9: SELLER FINANCING CONSISTENT WITH 2018

	Q1 2019		Q1 2018		Q1 2017	
	Cash at close*	Seller financing	Cash at close*	Seller financing	Cash at close*	Seller financing
<\$500K	86%	10%	84%	12%	77%	20%
\$500K - \$1MM	85%	13%	80%	11%	77%	18%
\$1MM - \$2MM	81%	17%	79%	11%	75%	19%
\$2MM - \$5MM	88%	8%	89%	11%	82%	12%
\$5MM - \$50MM	83%	6%	82%	8%	64%	15%

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

Cash at close

Year-over-year trends for cash at close and seller financing are relatively consistent. This reflects a positive shift over 2017 when sellers had to carry a larger portion of seller financing across most deal sectors.

"Cash at close remains consistent with last year's trends. That's indicative of the amount of cash reserves in the marketplace and a continued strong lending climate," said Ron Chernak, president of the FBB Group, Ltd. "Sellers get more cash at the closing table when confidence is high, and capital is abundant."

"Sellers may still need to support a transaction with some amount of alternative financing, typically seller financing or an equity rollover, in order to maximize value when dealing with a financial buyer, such as a Private Equity Group. Sellers that are willing to be creative are more likely to sell their businesses for more money in a shorter period of time," Chernak concluded.

Why are owners selling?

Retirement leads as the number one reason to sell across all sectors. In the Main Street market, burnout was the second leading trigger for sale. In the lower middle market, sellers also left for new opportunities or because they received an unsolicited offer.

FIGURE 10: TOP 2 REASONS SELLERS WENT TO MARKET

< \$500K	Retirement 31%	Burnout 21%
\$500K - \$1MM	Retirement 56%	Burnout 12%
\$1MM - \$2MM	Retirement 59%	Burnout 10%
\$2MM - \$5MM	Retirement 55%	New Opportunity 20%
\$5MM - \$50MM	Retirement 86%	Unsolicited Offer 14%

"Smaller business owners tend to wear more hats and carry a lot of stress and responsibilities on their shoulders. Unfortunately, those things lead to more than burnout; they can also lower your business value," said Warren Burkholder, president of NEVRG, Inc. "The more you can develop and empower your management team, and actually work yourself out of the business, the more it's typically worth to a buyer."

"For some business owners, an unsolicited offer can be the nudge that pushes them to market. This can be an efficient way to match your business up with a synergistic operation and sell quickly," said Laura Maver Ward, managing partner of Kingsbridge Capital Partners.

“That said, we recommend sellers engage an M&A advisor to ensure they are supported during the entire process, especially during negotiations with a vetted, sincere buyer who isn’t going to waste their time and money,” Ward continued. “A certified M&A advisor has the depth of experience to market a business using a targeted approach to search for other qualified buyers. Professional, experienced support can help ensure you don’t leave money on the table.”

Know your buyer

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

- + First time buyers (49%), serial entrepreneurs (30%), or existing companies (19%)
- + Motivated to buy a job (52%) or gain a horizontal add-on (21%)
- + Located within 20 miles (68%) or more than 100 miles (14%) of the seller’s location

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

- + First time buyers (42%), existing companies (33%), serial entrepreneurs (19%)
- + Motivated to buy a job (35%), gain a horizontal add-on (25%), or vertical add-on (23%)
- + Located within 20 miles (60%) or more than 100 miles (19%) of the seller’s location

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

- + Existing companies (34%), serial entrepreneurs (34%), or first-time buyers (21%)
- + Motivated to buy a job (38%), gain a horizontal add-on (31%), or realize better ROI than other investments (24%)
- + Located within 20 miles (48%) or within 100 miles (28%) of the seller’s location

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

- + Existing companies (45%), first time buyers (25%), or serial entrepreneurs (15%)
- + Motivated to buy a job (40%), gain a horizontal add-on (30%), or realize better ROI than other investments (20%)

- + Located within 20 miles (40%) or more than 100 miles (35%) of the seller’s location

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

- + Existing companies (36%), PE firms seeking a platform acquisition (19%), or PE firms seeking an add-on acquisition (29%)
- + Motivated to acquire a horizontal acquisition (79%) or achieve better ROI (14%)
- + Located more than 100 miles (71%) of the seller’s location

49%

First time buyers in the <\$500K sector

34%

Serial entrepreneurs in the \$1MM - \$2MM sector

79%

Motivated to acquire a horizontal acquisition in the \$5MM - \$50MM sector

What are they buying?

In the Main Street market, buyers are primarily looking for service, retail, manufacturing and construction businesses. In the lower middle market, business services, healthcare, manufacturing, construction, and wholesale distribution are dominating industry transitions.

FIGURE 11: TOP INDUSTRIES BY MARKET SECTOR

< \$500K	Restaurants	Personal Services	Consumer Goods/Retail
\$500K - \$1MM	Consumer Goods/Retail	Construction/Engineering	Personal Services
\$1MM - \$2MM	Manufacturing	Construction/Engineering	Wholesale/Distribution
\$2MM - \$5MM	Business Services	Healthcare/Biotech	Manufacturing
\$5MM - \$50MM	Construction/Engineering	Wholesale/Distribution	Business Services

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

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