

Q2 2019



MARKETPULSE

INTERNATIONAL BUSINESS BROKERS ASSOCIATION | M&A SOURCE | SECOND 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 Q2 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 Graziado Business School.

The Q2 2019 survey was conducted July 1-19, 2019 and was completed by 288 business brokers and M&A advisors. Respondents completed 260 transactions this quarter.

FIGURE 1: MARKET SEGMENTS STUDIED

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

One-third of Business Brokers Say Tariffs Are Impacting Business Owners Selling Their Business

Earlier this year, the National Federation of Independent Business reported about one-third of its membership has had negative impacts as a result of recent trade policy changes with Mexico, Canada or China. And our survey garnered consistent results.

In the 2nd quarter, roughly a third (32%) of Lower Middle Market advisors reported one or more of their sellers had been affected by tariff issues, and nearly a quarter (22%) of Main Street business brokers say the same.

Of those small business owners affected, some aren't putting their businesses on the market, while others are lowering their asking price, as a result of recent trade policy changes with China, Canada, and Mexico.

Of the affected Main Street brokers, nearly half (49%) say they've had one or more potential sellers decide not to put their business on the market due to tariff issues. Another 55% say they've had sellers reduce their target asking price.

In the Lower Middle Market, 41% of affected advisors had would-be sellers opt against sale plans over tariff issues, and 36% say sellers have reduced their target benchmark.

Similarly, only 15% of Lower Middle Market advisors say one or more of their business buyers are affected by trade/tariff issues. In Main Street, only 8% of brokers report one or more buyers were affected.

FIGURE 2: ADVISORS WHO SAY TRADE ISSUES HAVE CHANGED CLIENT PLANS TO SELL

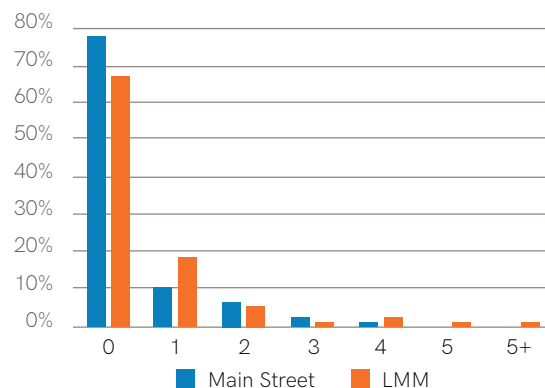
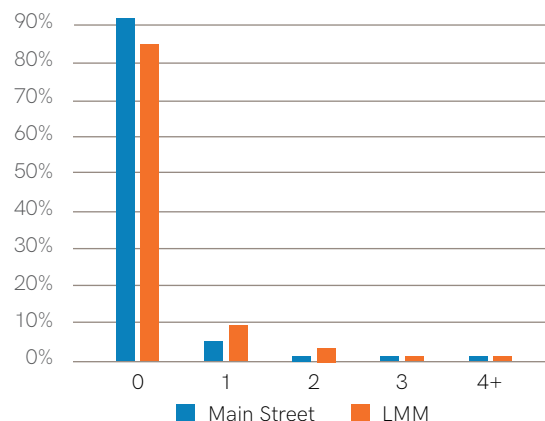


FIGURE 3: ADVISORS WHO SAY TRADE ISSUES HAVE CHANGED BUYER PLANS



22%

of Main Street advisors say sellers have been affected by tariff issues

32%

of Lower Middle Market advisors say sellers have been affected by tariff issues

Of the Lower Middle Market advisors who reported one or more of their buyers being affected have either lowered the price (49%) or decided against purchasing a target opportunity (46%). For Main Street, 58% of brokers reported one or more buyers deciding not to purchase, whereas 65% reduced their purchase price offered.

“What’s tragic is that M&A conditions are otherwise extremely strong for sellers right now. However, there is a substantial minority of small business owners affected by tariff issues who can’t take full advantage of this market to exit their business,” said Laura Maver Ward, managing partner of Kingsbridge Capital Partners. “Many business owners would rather lower their purchase price—reducing their retirement resources and their reward for years of hard work—rather than take a chance on missing their window to sell their company.”

“Sellers know a downturn is coming, and given the upcoming potential tariffs in September, we can’t be sure that trade issues will be resolved before it hits,” said Scott Bushkie, managing partner of Cornerstone Business Services. “Our manufacturing clients are being hardest hit, and many of them are choosing to wait it out.”

“It’s very likely that our manufacturing clients will either have to sell at a reduced value or hold another five, six, or seven years for the market to cycle back,” Bushkie continued. “When you’re looking forward to retirement, that extra time can feel like an eternity. I expect we’ll see some cases of burnout and lost ambition that will affect some owners’ business values even further.”

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Hot Industries

Looking at the overall market, construction/engineering, business services, and personal services led among hot industries. This is the first time construction/engineering has held such a prominent share of market activity.

FIGURE 4: TOP INDUSTRIES BY MARKET SECTOR

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

“The spotlight is on construction and engineering businesses this quarter, nearly knocking manufacturing—the previous leader—off the board,” said John Howe, M&AMI, director at Business Transition Strategies. “Part of that’s due to manufacturing clients holding back right now. They’re adjusting their businesses to new trade realities before they sell.”

“Construction activity is hot right now. Companies have strong balance sheets, so they’re expanding their facilities and state and local governments are reinvesting in roads. It makes sense that construction companies are selling now and getting out while things are good,” said Lisa Riley, principal of LINK Business-Phoenix.

“Private equity can drive a lot of trends. A few years ago, very few would look at construction. Now, they’re seeing opportunity to help great technicians and tradespeople become better business managers,” Riley continued. “We’re seeing rollups in niche specialties and its boosting activity in the wider market.”



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Knowing Your Buyer

Certain buyers are more motivated than others, prompting them to raise their offer price, accept concessions to deal structure, or accelerate the timeframe. In the Main Street market, advisors say individuals (72%) have been the most aggressive, followed distantly by privately held strategic buyers (12%).

In the Lower Middle Market, private equity (PE) firms had the highest motivation, with advisors reporting that PE-backed strategic buyers (22%) and PE-backed platform buyers (20%) were most aggressive, followed closely by privately held strategic buyers (19%) and high net worth individuals (14%).

But the most aggressive buyers don't always win the opportunity. Here's who advisors say actually took home the deals in Q2 2019:

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

- + First time buyers (48%), serial entrepreneurs (32%), or existing companies (18%)
- + Motivated to buy a job (53%), gain a horizontal add-on (21%)
- + Located within 20 miles (70%) or more than 100 miles (17%) of the seller's location

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

- + Serial entrepreneurs (49%), first time buyers (27%), or existing companies (20%)
- + Motivated to gain a horizontal add-on (36%), buy a job (29%), or realize better ROI than other investments (20%)
- + Located within 20 miles (56%) or within 50 miles (24%) of the seller's location

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

- + First time buyers (31%), serial entrepreneurs (31%), or existing companies (29%)
- + Motivated to gain a horizontal add-on (29%), buy a job (26%), or realize better ROI than other investments (23%)
- + Located within 20 miles (57%) or more than 100 miles (23%) of the seller's location

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

- + Serial entrepreneurs (38%), first time buyers (31%), or existing companies (31%)
- + Motivated to buy a job (46%), gain a horizontal add-on (31%), or realize better ROI than other investments (15%)
- + Located within 20 miles (39%) of the seller's location or more than 100 miles (31%)

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

- + Existing companies (54%), private equity firms (31%), serial entrepreneur (8%)
- + Motivated to acquire a horizontal add-on (54%) or vertical add-on (31%)
- + Located more than 100 miles (62%) of the seller's location, within 100 miles (39%)

"It's not surprising that advisors view private equity as the most aggressive buyers in the market. Private equity's sole existence is to find, buy, grow and sell companies," said Jeff Snell, principal of Enlign Advisors. "As M&A advisors, we get calls and emails daily from private equity firms all over the country. We don't hear from strategic firms as often because they have other things—like day-to-day business—pulling their focus."

In the Lower Middle Market, private equity firms had the highest motivation.

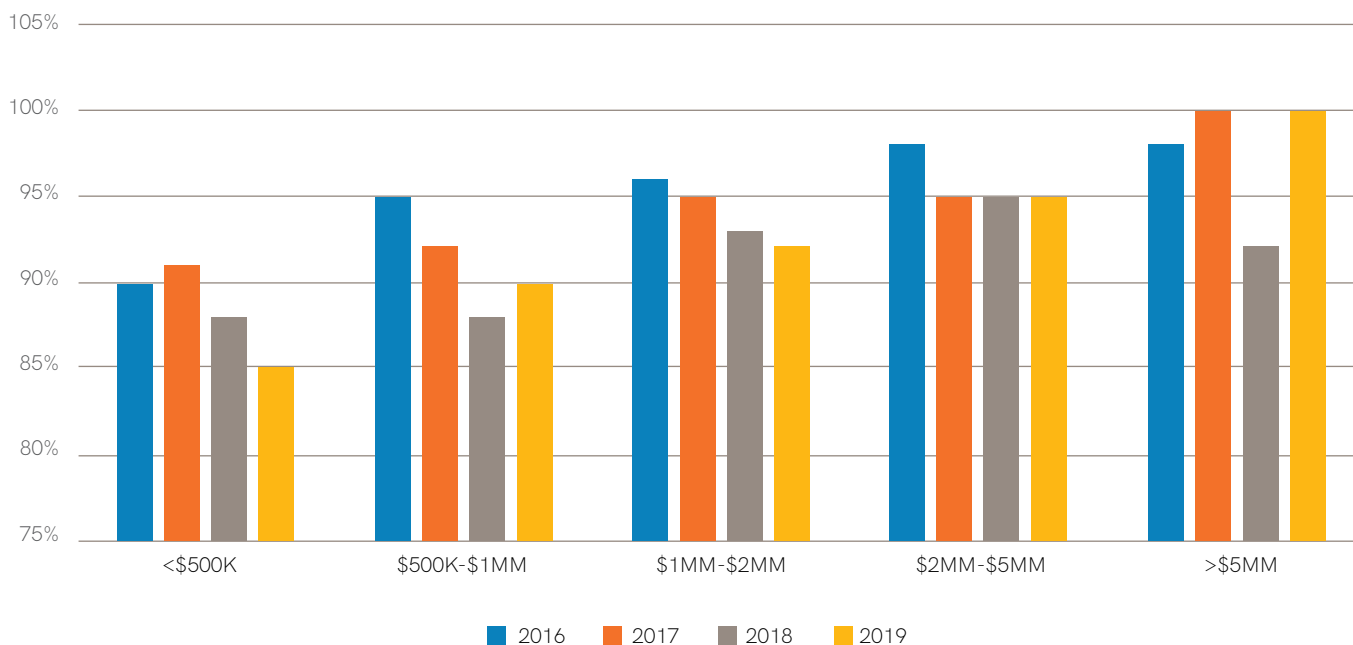
Where are business values trending?

In Q2, final sale prices came in anywhere from 85% to 100% of the pre-set asking price or internal benchmark. Lower middle market companies in the \$5M-\$50M range achieved the highest values at 100% of benchmark. (Typically, businesses with values of \$5 million or more do not have a published asking price.)

"Private equity is extremely active in the lower middle market, and that's pushing values upward," said Craig Everett, PhD, director of the Pepperdine Private Capital Markets Project at the Pepperdine Graziadio Business School. "Industry reports suggest private equity has nearly \$2.5 trillion in unspent cash right now. Many of them are shifting resources down to the Lower Middle Market in order to maximize their chances of winning a deal and putting that cash to work."

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FIGURE 5: FINAL PRICE REALIZED VS. ASKING PRICE, Q1 2017-2019



Multiples and Cash at Close

Multiples continue to remain strong in all categories, although only the \$5-\$50 million sector came in at or above peak. 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%.

FIGURE 6: MEDIAN MULTIPLES STRONG

	2019 Q2	2018 Q2	2017 Q2	2016 Q2	2015 Q2	2014 Q2
Median Multiple Paid (SDE)						
<\$500K	2.0	2.0	2.0	2.3	2.0	2.0
\$500K - \$1MM	2.5	2.5	2.3	2.8	2.5	2.8
\$1MM - \$2MM	3.1	3.3	3.3	3.3	3.0	3.1
Median Multiple Paid (EBITDA)						
\$2MM - \$5MM	4.0	3.8	4.3	4.0	4.0	4.5
\$5MM - \$50MM	5.9	5.9	5.4	5.1	5.0	5.4

Seller Financing

Notably, seller financing requirements dropped significantly year-over-year. Seller financing reached an all-time low of just 4% in the \$5M-\$50M sector, since the survey began in 2013.

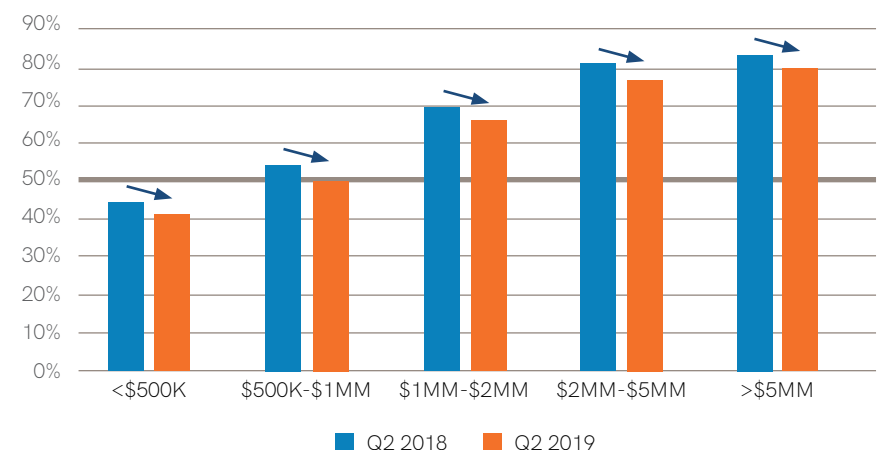
FIGURE 7: SELLERS GETTING MORE CASH AT CLOSE

	Q2 2019				Q2 2018			
	Cash at Close*	Seller Financing	Earn Out	Retained Equity	Cash at Close*	Seller Financing	Earn Out	Retained Equity
<\$500K	87%	12%	1%		83%	12%	1%	
\$500K-\$1MM	84%	10%			81%	16%	3%	
\$1-\$2MM	85%	8%	3%	1%	80%	17%	7%	2%
\$2-\$5MM	83%	8%			82%	14%	6%	
\$5-\$50MM	94%	4%	1%		80%	15%	3%	15%

Seller's Market

Sellers have the advantage in all market sectors \$1M and above, with 66% or more advisors pointing to a seller's market. Confidence is dropping across every sector through. And seller market sentiment in the \$500,000-\$1M sector dropped below 51% for the first time since Q3 2017.

FIGURE 8: SELLER'S MARKET SENTIMENT DROPPING



"It's still a strong marketplace with more buyers than sellers, and companies, for the most part, are doing well," said Randy Bring of Transworld Business Advisors. "But tariff issues are popping up and talk of a recession in the next 12 to 18 months is scaring some buyers away."

Time to Close

The average time to close is 8 months, more than a full month decrease from last year.

FIGURE 9: TIME TO CLOSE ON A DOWNTICK

	Q2 2019		Q2 2018	
	Months to Close	Months from LOI to Close	Months to Close	Months from LOI to Close
<\$500K	6	2	7	2
\$500K-\$1MM	7	2	8	3
\$1MM-\$2MM	8	3	9	3
\$2MM-\$5MM	8	3	9.5	3.5
\$5MM-\$50MM	11	4	12.5	3.5

"Competition is strong right now, and deal teams are holding buyers to a tighter timeframe in the marketing stage. If buyers want a shot at the best opportunities, they have to be ready to move quickly," said Leon Niemann, president of American Business Brokers, Inc.

Main Street Isn't Planning

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

Nevertheless, the majority of Main Street business owners fail to plan for the sale of their business. Advisors indicated that 85% of business owners in the <\$500,000 sector conducted no formal planning and did not meet with any type of advisor prior to engagement. Lower Middle Market business owners were more proactive, although nearly a third (31%) in the \$5M-\$50M sector failed to plan.

Even among business owners who do plan, 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 10: NO. 1 REASON SELLERS WENT TO MARKET

<\$500K	Retirement 32%
\$500K-\$1MM	Retirement 53%
\$1MM-\$2MM	Retirement 51%
\$2MM-\$5MM	Retirement 62%
\$5MM-\$50MM	Retirement 54%

FIGURE 11: BUSINESS OWNERS WHO DID NOT MEET WITH ADVISOR (WEALTH, CPA, ATTORNEY, OR BROKER) BEFORE ENGAGEMENT TO SELL

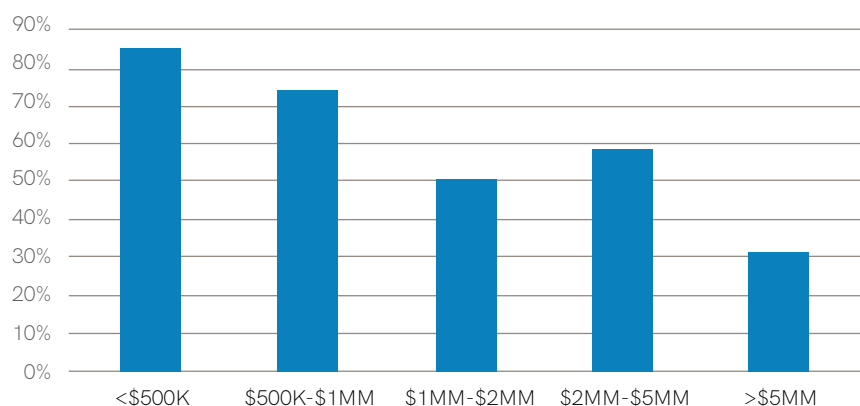
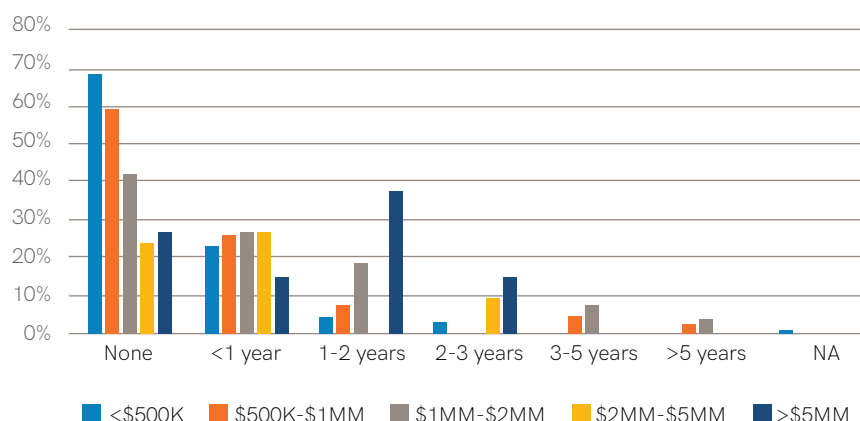


FIGURE 12: FEW BUSINESS OWNERS WHO DO PLAN, PLAN YEARS AHEAD



"The Baby Boomers are aging out of their businesses. The Exit Planning Institute estimates there's more than 4.5 million businesses expected to transition in the next 10 years in the U.S.," said David Ryan, advisor with Upton Financial Group. "But business owners who don't plan ahead may not exit on their own terms. They may have to accept a lower price or take on a lot of seller financing or earnouts, if they sell at all."

"We could see a shift in supply-and-demand as more Boomers go to market," Ryan continued. "That could change market dynamics significantly and create some real pain points for retiring Boomer business owners. Business owners who've prepared and built a business that's designed to sell—those are the ones who will come out ahead with a sizeable payday."

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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.

ABOUT INTERNATIONAL BUSINESS BROKERS ASSOCIATION

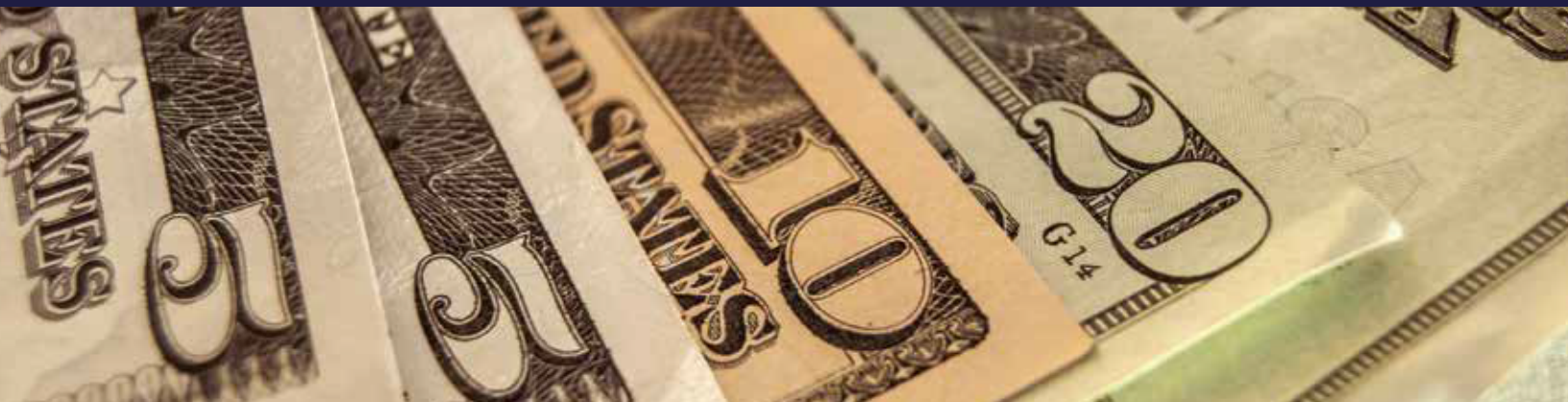
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