

Q3 2019



MARKETPULSE

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



PEPPERDINE GRAZIADIO





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 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 Q3 2019 survey was conducted October 1-15, 2019 and was completed by 236 business brokers and M&A advisors. Respondents completed 210 transactions this quarter.

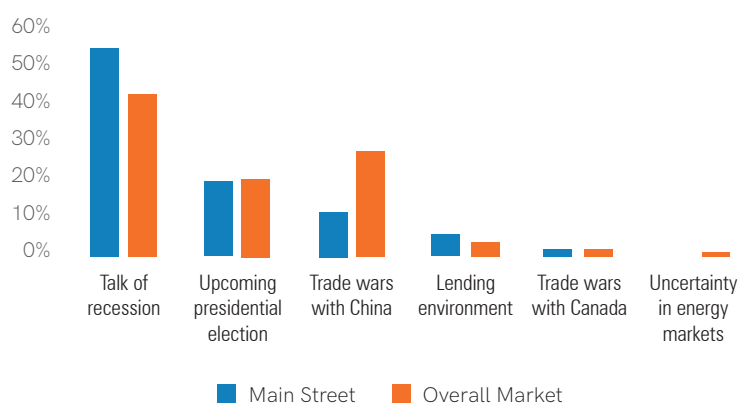
FIGURE 1: MARKET SEGMENTS STUDIED

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

Business Brokers Say Recession and Political Fears Driving Down Valuations

The recession isn't here yet, but enough people are talking about it and predicting it that it's already driving down business valuations, according to 53% of business brokers surveyed in October. Advisors also believe that uncertainty over the upcoming presidential election and trade wars with China are having an impact on the M&A market.

FIGURE 2: BIGGEST CONCERN AFFECTING BUSINESS VALUATIONS IN THE US



"The market doesn't like uncertainty, particularly on Main Street," said Craig Everett, PhD, director of the Pepperdine Private Capital Markets Project at the Pepperdine Graziadio Business School. "Small business owners are worried that a recession is coming, and trade issues are causing volatility. All that nervous energy means buyers are dialing back a bit — particularly on the smaller market deals."



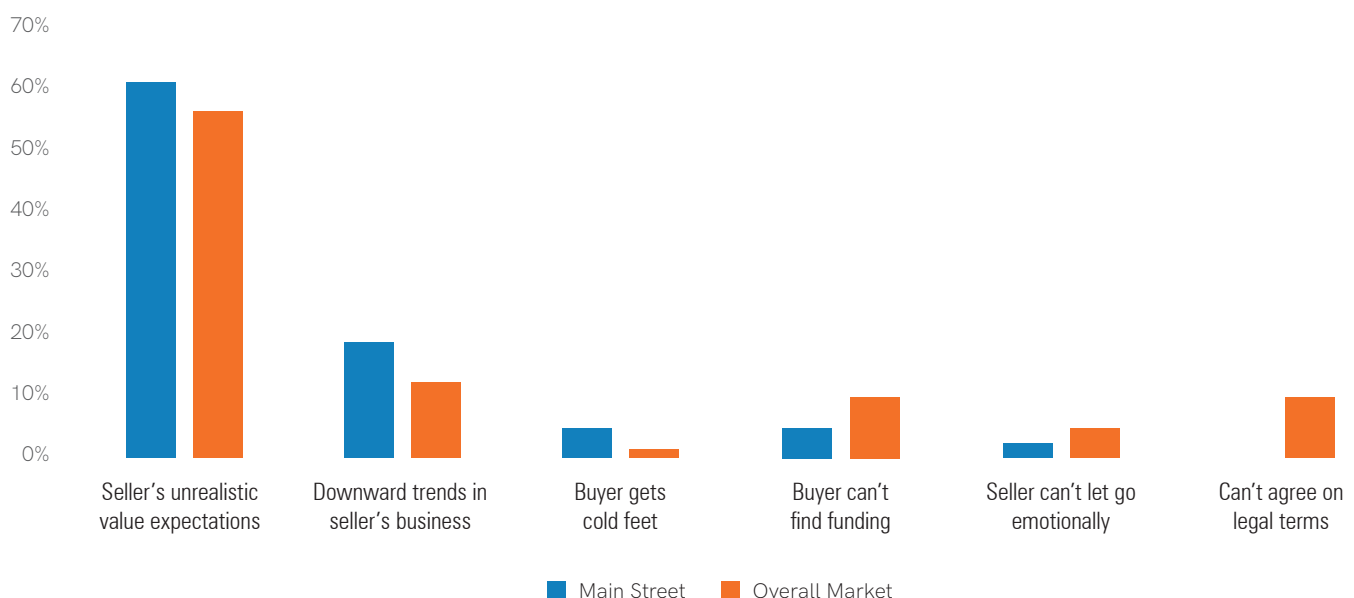
“Main Street transactions can really hinge on business confidence,” said Scott Bushkie, managing partner of Cornerstone Business Services. “We know that business confidence is dropping and that means individual buyers – the people who buy the majority of Main Street businesses – aren’t as active right now.”

“Confidence always gets shaky as we enter an election season,” continued Bushkie. “There’s this general escalation of reports pointing out economic weaknesses and policy flaws, and people sometimes internalize that negativity. I think we may be feeling that even earlier than normal this time around.”

Unrealistic Expectations Remains Leading Reason Businesses Don’t Sell

What’s the biggest stumbling block to getting deals done? Advisors say that it’s business owners who think their business is worth more than its realistic market value. Advisors cited “unrealistic value expectations” as the number one reason businesses don’t sell on both Main Street and the Lower M&A market. Other key hurdles include downward trends, funding issues, and disagreements over legal terms.

FIGURE 3: NO. 1 REASON BUSINESSES DON’T SELL



“It’s pretty common to encounter a seller with grand value expectations. People can spend their whole lifetime building a business, and they’re really proud of what they’ve created,” said David Ryan, advisor with Upton Financial Group.

“Unfortunately, when someone wants out of their business doesn’t always align with market realities. We try to educate and help sellers understand the gaps between their goal and what buyers will likely pay.”

“Sometimes we run into problems when other advisors make unrealistic promises or agree to take a business to market knowing the seller’s target price is unrealistic,” said Lisa Riley, principal of LINK Business-Phoenix.

“More often than not, the business lingers on the market, the seller’s energy wanes, and business value starts to erode. Advisors who agree to shoot for the moon are really doing their clients a disservice in the end.”

“We won’t take an engagement unless we believe we can meet a seller’s expectations,” continued Riley. “But before we turn a business owner away, we try to have a conversation about what it would take to meet their goals. We talk about longer-term changes that would add value to their business as well as alternative deal structures, such as earn outs or management contracts that could help bridge the valuation gap.”

Main Street Businesses Aren’t Planning

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

FIGURE 4: NO. 1 REASON SELLERS WENT TO MARKET

| | | |
|--------------|----------------|---|
| <\$500K | Retirement 32% | Burnout 18% |
| \$500K-\$1MM | Retirement 50% | Burnout 18% |
| \$1MM-\$2MM | Retirement 62% | Burnout 15% |
| \$2MM-\$5MM | Retirement 59% | (tie) Burnout / Family 18% |
| \$5MM-\$50MM | Retirement 44% | (tie) Burnout / New Opportunity / Unsolicited Offer 13% |

Nevertheless, the majority of Main Street business owners fail to plan for the sale of their business (Figure 5). Advisors indicated that 83% of business owners in the <\$500,000 sector conducted no formal planning prior to engagement. Lower Middle Market business owners were more proactive, although more than a third (38%) in the \$5M-\$50M sector also failed to do any advance planning.

Even among business owners who do plan (Figure 6), 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 5: BUSINESS OWNERS WHO ENGAGED IN NO FORMAL PLANNING BEFORE ENGAGEMENT

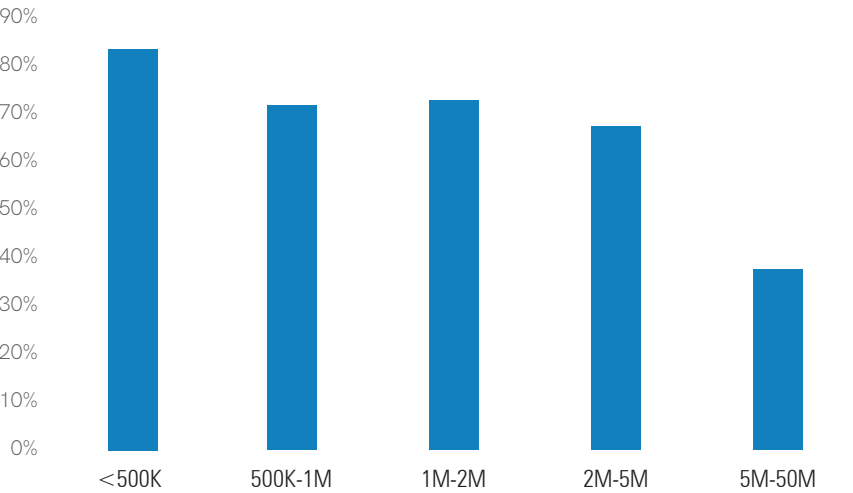
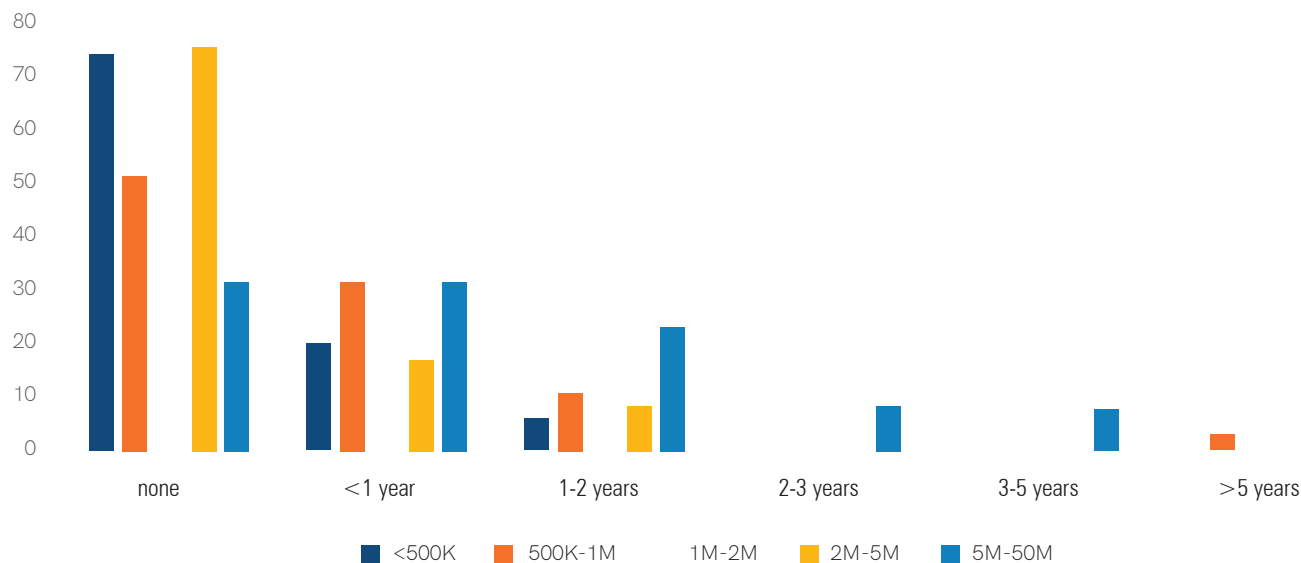


FIGURE 6: OF THOSE WHO PLAN, FEW BUSINESS OWNERS PLAN YEARS AHEAD



"It's never too early to start planning! Every business owner should know when he or she wants to leave, how much is needed after taxes, and to whom they will transfer the business (family, management, strategic buyer or financial buyer)," said Laura Maver Ward, managing partner of Kingsbridge Capital Partners. "I am always willing to have a conversation with business owners to discuss the value drivers that savvy buyers review. I am passionate about helping business owners prepare themselves and their business for a successful transition."

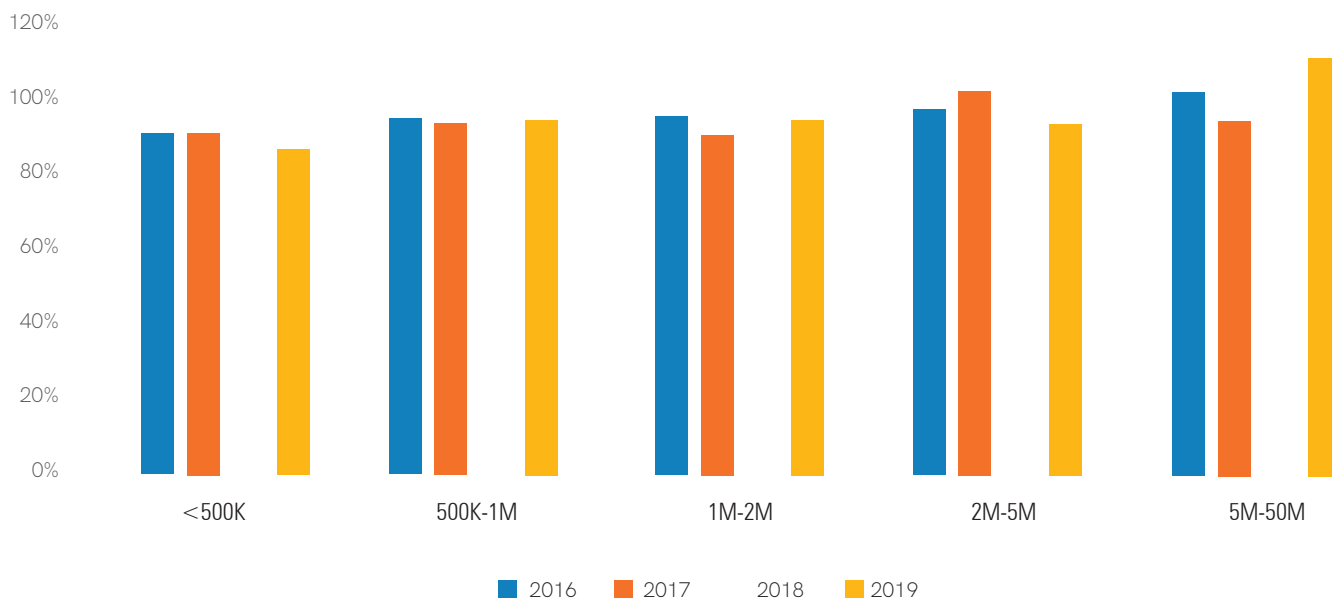
Where Are Business Values Trending?

In Q3 2019, final sale prices came in anywhere from 85% to 109% of the pre-set asking price or internal benchmark. Lower Middle Market companies in the \$5M-\$50M range achieved the highest values at 109% of benchmark. Typically, businesses with values of \$5M or more do not have a published asking price, however, there is a benchmark price (expected value range).

"Businesses with values of \$5 million or more came in well above expectations in Q3," said Jeff Snell, principal of Enlign Advisors. "While this sector typically comes in at or close to benchmark, it's unusual to see results nine percentage points above target. Demand for Lower Middle Market opportunities remains strong."

"Businesses with values of \$5 million or more came in well above expectations in Q3."

FIGURE 7: FINAL PRICE REALIZED VS. ASKING PRICE, Q3 2016 - Q3 2019



Multiples

Multiples continue to remain strong in all categories, with the largest market sector coming in at a year-over-year 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 8: MEDIAN MULTIPLES STRONG

| | 2019 Q3 | 2018 Q3 | 2017 Q3 | 2016 Q3 | 2015 Q3 | 2014 Q3 |
|-------------------------------|------------|------------|------------|------------|------------|------------|
| Median Multiple Paid (SDE) | | | | | | |
| <\$500K | 2.0 | 2.0 | 2.0 | 2.3 | 2.0 | 2.0 |
| \$500K - \$1MM | 2.8 | 2.8 | 2.5 | 3.0 | 2.5 | 2.5 |
| \$1MM - \$2MM | 3.3 | 3.3 | 3.1 | 3.3 | 2.8 | 3.3 |
| Median Multiple Paid (EBITDA) | | | | | | |
| \$2MM - \$5MM | 4.4 | 4.0 | 4.5 | 4.5 | 4.0 | 4.0 |
| \$5MM - \$50MM | 6 | 5.4 | 5 | 5.8 | 5.3 | 5.1 |

Cash at Close

Sellers are still carrying 10-15% of financing across most sectors.

FIGURE 9: CASH AT CLOSE

| | Q3 2019 | | | | Q3 2018 | | | |
|--------------|----------------|------------------|----------|-----------------|----------------|------------------|----------|-----------------|
| | Cash at Close* | Seller Financing | Earn Out | Retained Equity | Cash at Close* | Seller Financing | Earn Out | Retained Equity |
| <\$500K | 85% | 11% | 2% | 1% | 80% | 16% | 1% | |
| \$500K-\$1MM | 85% | 14% | 1% | | 83% | 15% | | |
| \$1-\$2MM | 93% | 6% | 1% | | 80% | 16% | 1% | 1% |
| \$2-\$5MM | 86% | 13% | | | 90% | 9% | 2% | |
| \$5-\$50MM | 88% | 6% | 1% | 3% | 78% | 7% | 2% | 1% |

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

"Lenders always like to see sellers keep some skin in the game," said Justin Sandridge of Murphy Business Sales-Baltimore East. "When sellers aren't willing to finance any of the purchase price that sends warning signals to buyers and lenders alike. Refusing to provide seller financing is like holding up a giant 'no confidence' sign and it's likely to scare other parties away from the deal."



Time to Close

The average time to close is 8.2 months, a slight downtick over the year prior.

FIGURE 10: TIME TO CLOSE

| | Q3 2018 | | Q3 2019 | |
|--------------|-----------------|--------------------------|-----------------|--------------------------|
| | Months to Close | Months from LOI to Close | Months to Close | Months from LOI to Close |
| <\$500K | 7 | 2 | 6 | 2 |
| \$500K-\$1MM | 8 | 3 | 8 | 3 |
| \$1MM-\$2MM | 9 | 3 | 9 | 4 |
| \$2MM-\$5MM | 9 | 3 | 8 | 4 |
| \$5MM-\$50MM | 10 | 3 | 10 | 4 |

Know Your Buyer

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

- + First time buyers (46%), serial entrepreneurs (34%), or existing companies (20%)
- + Motivated to buy a job (48%), gain a horizontal add-on (27%)
- + Located within 20 miles (74%) or more than 100 miles (15%) of the seller's location

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

- + First time buyers (43%), existing companies (30%), or serial entrepreneur (28%)
- + Motivated to buy a job (35%), gain a horizontal add-on (30%), or realize better RIO than other investments (18%)
- + Located within 20 miles (58%) or more than 100 miles (28%) of the seller's location

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

- + First time buyers (44%), serial entrepreneurs (26%), or existing companies (21%)
- + Motivated to buy a job (32%), gain a horizontal add-on (26%), or realize better RIO than other investments (21%)
- + Located within 20 miles (47%) or within miles (30%) of the seller's location

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

- + First time buyers (47%) or existing companies (41%)
- + Motivated to buy a job (41%) or gain a horizontal add-on (35%)
- + Located within 20 miles (41%) of the seller's location or more than 100 miles (29%)

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

- + Existing companies (44%) or private equity firms (44%)
- + Motivated to acquire a horizontal add-on (44%) or vertical add-on (25%)
- + Located more than 100 miles (75%) of the seller's location

What Are They Buying?

Looking at the overall market, personal services led among hot industries. Construction/engineering and manufacturing also held a prominent share of market activity.

FIGURE 11: TOP INDUSTRIES BY MARKET SECTOR

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

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For the last 50 years, the [Pepperdine Graziadio Business School](#) has challenged individuals to think boldly and drive meaningful change within their industries and communities. Dedicated to developing Best for the World Leaders, the Graziadio School offers a comprehensive range of [MBA, MS, executive, and doctoral degree programs](#) grounded in integrity, innovation, and entrepreneurship. The Graziadio School advances experiential learning through small classes with distinguished faculty that stimulate critical thinking and meaningful connection, inspiring students and working professionals to realize their greatest potential as values-centered 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 the 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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