



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

MARKETPULSE

QUARTERLY SURVEY REPORT

THIRD QUARTER 2014



THE IBBA AND M&A SOURCE MARKET PULSE SURVEY REPORT Q3 2014

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 2014 survey was completed by 242 respondents, representing 18 regional and international business broker and M&A associations. Half of the respondents (50%) had at least 10 years of experience in the M&A and/or business brokerage industry. Participating advisors reported closing 252 transactions in Q3 2014.

Figure 1: Market Segments Studied

Main Street	Lower Middle Market
Less than \$500K	\$2MM - \$5MM
\$500K - \$1MM	\$5MM - \$50MM
\$1MM - \$2MM	

Market Pulse survey results are available to IBBA and M&A Source members who participate in each quarterly survey. This consists of two 100-plus page documents of up-to-date relevant information on the state of the marketplace and compiled by Dr. Craig Everett, assistant professor of finance at Pepperdine University's Graziadio School of Business and Management and director of the Pepperdine Private Capital Markets Project. To become a member, please contact the IBBA and M&A Source headquarters at admin@ibba.org or (888) 686-4222.

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KEY FINDINGS:

The majority of respondents (51%) indicated that deal flow increased compared to 12 months prior, with only 16% reporting a decline. Moreover, 37.5% of advisors report that closing ratios have increased, meaning they're selling more of the businesses they work with.

Figure 2: Business Characteristics Compared to 12 Months Prior

Characteristics	Decreased significantly	Decreased slightly	Stayed about the same	Increased slightly	Increased significantly	Score (1 to 5)
Deal flow	4.1%	11.9%	33.3%	38.8%	11.9%	3.4
Ratio of businesses sold / total listings	4.2%	12.6%	45.8%	29.9%	7.5%	3.2
Deal multiples	0.5%	7.5%	67.9%	22.2%	1.9%	3.2
Business exit opportunities	1.9%	10.0%	55.7%	28.2%	6.2%	3.3
Amount of time to sell business	0.5%	11.2%	57.9%	22.0%	8.4%	3.3
Difficulty selling business	0.9%	13.6%	55.4%	20.7%	9.4%	3.2
Business opportunities for growth	0.0%	8.1%	47.9%	40.3%	3.8%	3.4
General business conditions	1.4%	11.9%	39.4%	44.0%	3.2%	3.4
Margin pressure on companies	0.0%	11.7%	60.7%	22.4%	5.1%	3.2

“It’s not surprising to see that the majority of participants said deal flow is up and more deals are getting done over last year,” said Scott Bushkie, president of Cornerstone Business Services. “With the current market dynamics, we’re seeing more Boomers selling their businesses, large demand from buyers, a record amount of cash to invest, and an increased appetite for lending. That adds up to more businesses getting sold.”

Market Pulse Survey results are consistent with data reported by BizBuySell, an industry leading website for connecting buyers and sellers. BizBuySell reported a 17.9% increase in Q3 2014 sales compared to one year ago. BizBuySell also reported that Q3 2014 was the highest performing third quarter since the organization began tracking sales in 2007.

“For sellers waiting to time the market just right, I think we might be at the peak soon if we’re not there already,” Bushkie continued. “We have 68% of advisors saying deal multiples were the same as 12 months ago, indicating the market may have plateaued. Unfortunately, the only time you can positively identify a peak is after the crash, when values could be off 30 to 40%.”

“Since smaller companies are often seen as having riskier cash flows, Main Street businesses are at a disadvantage,” said Lisa Riley, president of LINK-Phoenix. “Lending for businesses in that sector still has not reached lending levels for lower middle market companies.”

However, about a third (30.4%) of advisors report a slight increase in time to close and some additional difficulties in getting deals done (30.1%)—findings which could be influenced by Main Street survey results, as those brokers are more likely to view the market as a buyer’s market (as indicated further below).

That said, outlook remains positive as advisors demonstrate increasing confidence in general business conditions. Responding to a question on expectations for the next 12 months, advisors still show strong confidence that deal flow and closing ratios will continue to increase in the next 12 months (3.7 mean, each, on a 5 point scale). And they maintain optimism for positive business climate going forward (3.4 mean).

Regarding the lending climate over the last 12 months, respondents indicate that financing was easier to arrange for larger transactions. On a seven point scale (in which seven indicates debt was “very easy” to arrange), businesses with revenues of \$1 million or greater ranked mean values of 4.0 or better, increasing consistently with business size. The smallest Main Street businesses with revenues of \$100,000 were the most difficult to finance through lending options, with a mean score of 2.8.

Figure 3: Ease of Arranging Debt for Transactions by Revenue Size

Revenues	Mean Score
\$100K	2.8
\$500K	3.5
\$1MM	4.0
\$5MM	4.3
\$10MM	4.4
\$15MM	4.6
\$25MM	4.7

“Lenders are looking for the highest return on investment with the least risk, and that places Main Street businesses at a disadvantage,” said Lisa Riley, president of LINK-Phoenix. “We know that lenders who partner with the SBA can be more aggressive on Main Street deals, but lending in that sector still isn’t at lower middle market levels.”

BUYER VS. SELLER MARKET

Despite strong sales reports from the Main Street sectors, those advisors were increasingly likely to categorize the market as a “buyer’s market.” Advisor perceptions consistently shift to a seller’s market as deal size increases.

In Q3, 73% of advisors reported that the smallest businesses (deals under \$500,000) face a buyer’s market, up nine percentage points over Q2. Likewise, 63% advisors reported that business valued between \$500,000-\$1MM faced a buyer’s market, up 10 percentage points. Meanwhile, perceptions of the lower middle market remain relatively unchanged from Q2 to Q3.

Figure 4: Main Street Increasingly a Buyer’s Market, Q2 to Q3

	Q2 - Buyer’s Market	Q3 - Buyer’s Market
<\$500K	69%	78%
\$500K-\$1MM	53%	63%
\$1MM-\$2MM	52%	53%

Figure 5: Advisors Who View Market as a Buyer’s or Seller’s Market Q3

	Buyer’s Market	Seller’s Market
<\$500K	78%	22%
\$500K-\$1MM	63%	37%
\$1MM-\$2MM	53%	47%
\$2MM-\$5MM	47%	53%
\$5MM-\$50MM	37%	63%

“One reason that Main Street is more of a buyer’s market may be that Baby Boomer sellers continue to come out in larger numbers, while the buyer pool remains largely the same,” said Joe Lindsey, president of Dailey Resources, Inc. “We can see from the survey that retirement is the leading factor driving sales, and we can see that buyers are more likely to be Gen Xers than Boomers. So more Boomers selling and a smaller generation people buying means Main Street is up against a numbers game.”

“Meanwhile, in the lower middle market you have existing companies competing against a bevy of private equity groups and a new, growing number of family offices,” Lindsey continued. “So even while more Boomers are selling, there’s still such an excess of well-funded buyers in this sector that it will take several more years for the market to rebalance.”

“With the current market dynamics, we’re seeing more boomers selling their businesses, large demand from buyers, and an increased appetite for lending,” said Scott Bushkie, president of Cornerstone Business Services. “That adds up to more businesses being sold. For sellers waiting to time the market just right, I think we might be at the peak soon as 68% of advisors say deal multiples were the same as 12 months ago, indicating the market may have plateaued.”

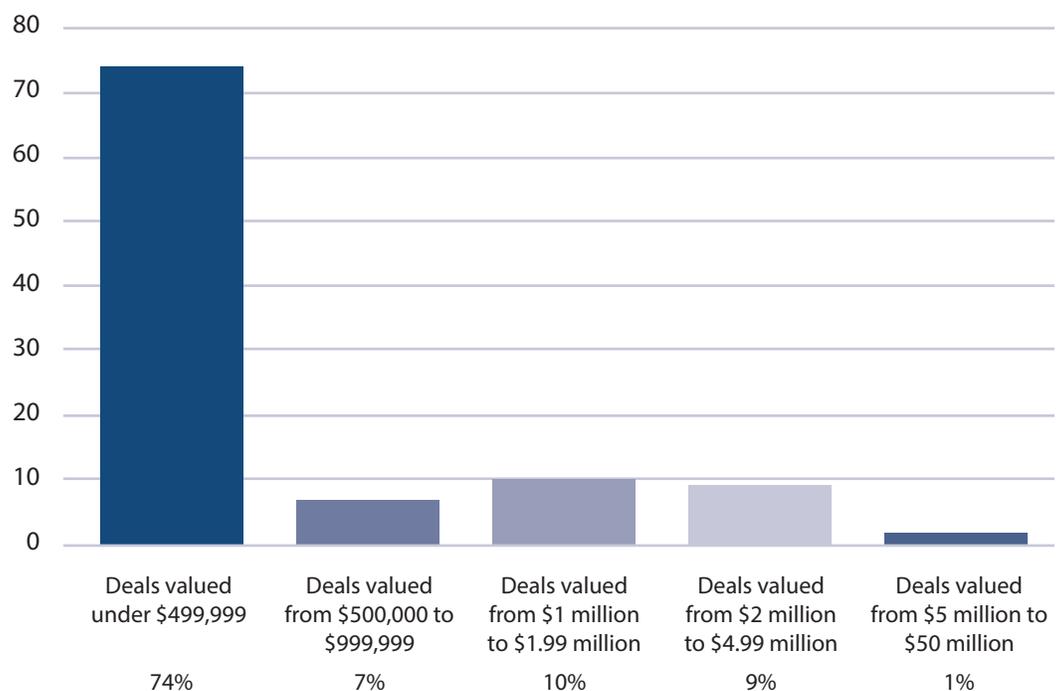
FAILURE TO CLOSE

Survey results show that the smallest Main Street business were the most difficult to sell. Among the business engagements that terminated without a sale in the last quarter, nearly three quarters of them (74%) fell among deals valued at less than \$500,000. Deals valued at \$5 million and above were the most likely to sell, at just 1% of the unsuccessful terminations.

As in previous surveys, advisors were also asked to indicate which seller errors impacted deal success in the last quarter. Unrealistic expectations led by a significant margin in every sector, followed most often by declining business sales and burnout.

“It’s vitally important to work with a business broker/M&A advisor whom you can trust to give you an accurate estimate of value on your company before you go to market,” said David Ryan, president of Upton Financial Group. “Otherwise, you run the risk of pricing your business too low and leaving money on the table or, more commonly, pricing it to high. If you spin your wheels trying to sell an overpriced businesses, you’re lead yourself into burnout and reap the other ill effects of holding on too long.”

Figure 6: Percent of Transactions Terminated without Closing



MEDIAN TIME TO CLOSE

Meanwhile, median time to close increased in every market sector when compare to Q2, returning to more of an industry norm.

Figure 7: Median Time to Close (in months)

	Q3 2014	Q2 2014	Q3 2013
<\$500K	4	3	4
\$500K-\$1MM	7	5	5
\$1MM-\$2MM	7	6	7
\$2MM-\$5MM	9	6	7
\$5MM-\$50MM	9	6	10

“It appears sellers this quarter were more willing to accept a little less to get a deal done,” continued Everett. “I expect we’re seeing sellers who should have sold in 2008 or 2009 coming to the closing table now. Those sellers know what it’s like to miss their window of opportunity and their mindset right now is to get a deal done, even if the numbers are down by a fraction. They’re not going to hold out a second time.”

SELLER & BUYER MOTIVATIONS

Once again, retirement dominated as the leading factor driving business owners to market. It was the number one reason in every market sector, followed by “new opportunities” among Main Street sellers and “burnout” in the lower middle market.

Buyer motivations, however, were mixed. In the lower middle market, buyers were most likely seeing horizontal add-ons or a higher return than other (financial) investment opportunities. Main Street buyers were more likely to be “buying a job,” although horizontal add-on and better ROI were also leading factors for businesses valued between \$1 million and \$2 million.

Individual buyers led the market, with most of those buyers being serial entrepreneurs or people who had previously owned a business. This would appear to be consistent with the survey results for seller motivations, indicating “new opportunities” as one of the leading drivers.

Compared year over year, the strategic buyers were only slightly more active.

Figure 8: Buyer Types Q3

	1st Time Individual	Individual/ Experienced Owner	Existing Company	PE - Platform	PE – Add On
<\$500K	47.5%	39%	13.5%		
\$500K-\$1MM	32.3%	41.9%	22.6%		
\$1MM-\$2MM	12.9%	51.6%	19.4%	6.5%	9.7%
\$2MM-\$5MM	22.2%	11.1%	44.4%	22.2%	
\$5MM-\$50MM		10%	40%	30%	20%

Compared year over year, the strategic buyers were only slightly more active. Private equity also gained a little ground over last year, edging out individual buyers.

New this survey, respondents reported on buyer age for deals closed in the last quarter. When the buyer was an individual, the majority of buyers fell into Generation X (people currently age 30-49). So-called “Trailing Boomers” (age 50-59) accounted for 31% of business buyers compared to the oldest Gen Xers who accounted for 34%.

Figure 9: Buyer Age

Under 30	30-39	40-49	50-59	60-69
7%	19%	34%	31%	8%

HOT INDUSTRIES

Manufacturing stood out as a hot industry for lower middle market and Main Street. This quarter, it showed up as the top one or two industry for most market sectors.

Manufacturing stood out as a hot industry for lower middle market and Main Street M&A this quarter.

Figure 10: Leading Industries by Sector, Q3 2014

<\$500K	Restaurants 25%,	Personal Services 19%,
\$500K-\$1MM	Business Services 23%,	Mnfg 13%
\$1MM-\$2MM	Mnfg 16%,	Consumer Goods 13%, Personal Services 13%
\$2MM-\$5MM	Const/engr 22%,	Wholesale 17%, Mnfg 17%, Business Services 17%
\$5MM-\$50MM	Business Services 30%,	Mnfg 30%

VALUATION MULTIPLES

Compared to last quarter, valuations show a slight downtick in most market sectors. Only businesses in the \$1 million to \$2 million sector showed an increase.

Figure 11: Median Multiples

	Q3 2014	Q2 2014	Q3 2013
<\$500K	2 (SDE)	2 (SDE)	2.0
\$500K-\$1MM	2.5 (SDE)	2.8 (SDE)	2.8
\$1MM-\$2MM	3.3 (SDE)	3.1 (SDE)	3.0
\$2MM-\$5MM	4.0 (EBITDA)	4.5 (EBITDA)	4.3
\$5MM-\$50MM	5.1 (EBITDA)	5.4 (EBITDA)	5.8

“In the lower middle market, we saw a wide range of multiples, especially in the \$5 million to \$50 million sector where multiples varied from 3.25 to almost seven times EBITDA,” said Dora Lanza, chair of the M&A Source and president of Plethora Businesses.

The table below is a further illustration of current multiples. It shows a selected range of multiples and the percentage of businesses that sold within that range in Q3 2014.

“It appears sellers this quarter were more willing to accept a little less to get a deal done,” said Craig R. Everett, Ph.D, Director, Pepperdine Private Capital Markets Project Graziadio School of Business and Management Pepperdine University. “Multiples may be slightly off peak, but they’re still very strong, historically speaking. I expect we’re seeing sellers who should have sold in 2008 or 2009 at the closing table now. Those sellers know what it’s like to miss their window of opportunity, and their mindset right now is to get a deal done, even if the numbers are down by a fraction. They’re not going to hold out a second time.”

Figure 12: Multiples – Leading Ranges

	Q3 2014	% Within Range
<\$500K	1.75-2.75 (SDE)	50%
\$500K-\$1MM	2.25-2.75 (SDE)	73%
\$1MM-\$2MM	3.0-3.75 (SDE)	52%
\$2MM-\$5MM	3.0-5.25 (EBITDA)	72%
\$5MM-\$50MM	4.25-6.75 (EBITDA)	77%

Advisors are showing cautious expectation that valuation multiples will increase in Q4, ranking all market sectors at a mean 3.1 or 3.2 on a five point scale in which 5.0 represents a great increase.

“In the lower middle market, we saw a wide range of multiples, especially in the \$5 million to \$50 million sector where multiples varied from 3.25 to almost seven times EBITDA,” said Dora Lanza, chair of the M&A Source and president of Plethora Businesses. “In today’s market that highlights the importance of finding the right advisor who can tell the right story to the right people. Because if you’re talking to the wrong people, you’re not going to maximize value.”

BUYER LOCATION

Results for buyer location showed that larger businesses are more likely to sell to buyers out of state. However, international buyers remain interested in businesses of all sizes.

Figure 13: Buyer Location

	Within City	Within State	Within Country	International
<\$500K	33%	42%	15%	10%
\$500K-\$1MM	32%	48%	13%	6%
\$1MM-\$2MM	42%	35%	13%	10%
\$2MM-\$5MM	11%	28%	56%	6%
\$5MM-\$50MM	-	30%	60%	10%
	Within 20 miles	Within 50 miles	Within 100 miles	More than 100 miles
<\$500K	52%	21%	6%	22%
\$500K-\$1MM	61%	19%	-	19%
\$1MM-\$2MM	48%	19%	3%	29%
\$2MM-\$5MM	11%	44%	11%	33%
\$5MM-\$50MM	-	-	20%	80%

“When evaluating an advisor, make sure he or she has the right buyer reach and marketing tactics to match up with the size of your business,” said Steve Wain, chair of the IBBA and president of Calder Associates. “Some businesses need much more local tactics while larger businesses need advisors with the ability to reach national buyer pools.”

FINANCING STRUCTURE

Compared to last year, alternative financing is still key to getting deals done, even though lenders have increased their appetite for lending. Whether seller financing is necessary to get the deal done or used as leverage to maintain seller support after a sale, it’s still key to getting deals done in today’s market.

Figure 14: Alternative Financing, year over year

	Q3 2014			Q3 2013		
	Retained Equity	Seller Financing	Earn Out	Retained Equity	Seller Financing	Earn Out
<\$500K		18%	2%		17%	3%
\$500K-\$1MM	1%	11%	1%		17%	2%
\$1MM-\$2MM	6%	16%	3%		13%	2%
\$2MM-\$5MM	NA	20%	2%	10%	5%	5%
\$5MM-\$50MM	15%	11%	-	10%	6%	8%

NOTES

ABOUT PEPPERDINE UNIVERSITY GRAZIADIO SCHOOL OF BUSINESS AND MANAGEMENT

Founded on the core values of integrity, stewardship, courage, and compassion, Pepperdine University's Graziadio School of Business and Management has been developing values-centered leaders who advance responsible business practice since 1969. Student-focused, experience-driven and globally oriented, the Graziadio School offers fully accredited MBA, Masters of Science, bachelor's completion and non-degree executive business programs for business professionals, entrepreneurs, managers and senior executives at all stages of their professional and personal development.

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

ABOUT INTERNATIONAL BUSINESS BROKERS ASSOCIATION (IBBA)

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.

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.

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The Certificate in Private Capital Markets (CIPCM) is a three-day curriculum-based training program led by Dr. Craig R. Everett, director of the ground-breaking research Pepperdine Private Capital Market Project and co-editor of the *Journal for Entrepreneurial Finance*.

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