

Q1 2016



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

# MARKETPULSE

QUARTERLY SURVEY REPORT

FIRST QUARTER 2016



# THE IBBA AND M&A SOURCE MARKET PULSE SURVEY REPORT Q1 2016

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 University Graziado School of Business and Management.

The Q1 2016 survey was completed by 370 business brokers and M&A advisors, representing 40 states. Half of the respondents (51%) had at least 10 years of experience in the industry. Respondents completed 339 transactions this quarter.

Figure 1: Market Segments Studied

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

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 at the Pepperdine University 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](mailto:admin@ibba.org) or (888) 686-4222.

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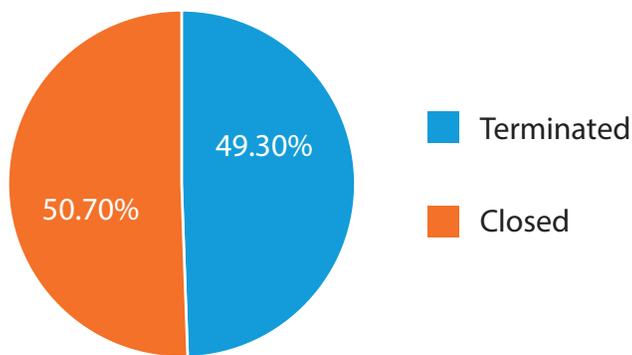
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## HALF OF ALL BUSINESSES SELL

Going by numbers, the odds of starting a successful business appear to be better than selling one. New businesses have about a 50% chance of surviving more than five years. Meanwhile, other estimates suggest only 25% of businesses will ever sell. Those estimates drop even lower for the smallest Main Street operations. Yet Market Pulse Survey brokers report an average closing ratio of just over 50% for deals of all sizes.

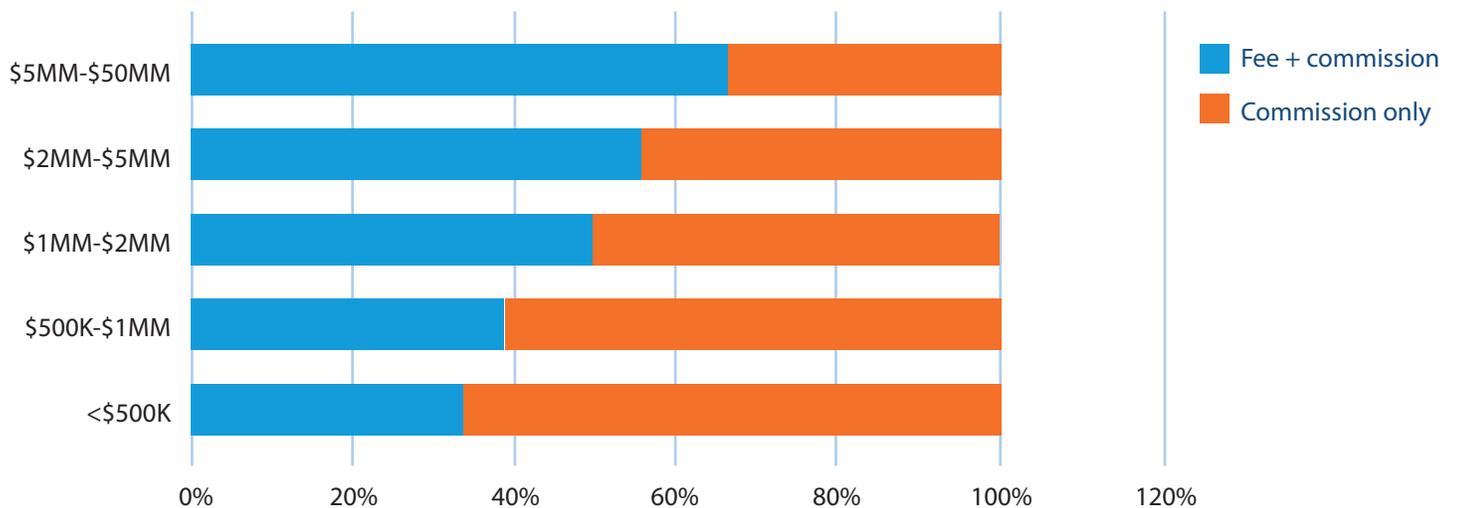
*“This indicates how much value there can be in using a proven advisor to sell your business,” says Scott Bushkie, president of Cornerstone Business Services and chairperson for the IBBA. “Even though you’ll be paying a fee to help get your business sold, you will significantly increase your chances of success. Many sellers consider this a good investment in maximizing value and getting a return for all their hard work.”*

Figure 2: Terminations and Closings



The survey also shows most advisors work on a commission fee structure for a successfully closed business. In the Main Street sector, roughly a third of brokers require some kind of upfront retainer, and the use of retainer fees increases as deal size grows

Figure 3: Typical Fee Structure



## WHY ARE OWNERS SELLING?

Retirement continues to lead as the number one reason to sell across all sectors, followed most often by burnout. Family issues are also a common contributing factor in the lower middle market.

Figure 4. Percent of Sellers Entering Market for Retirement

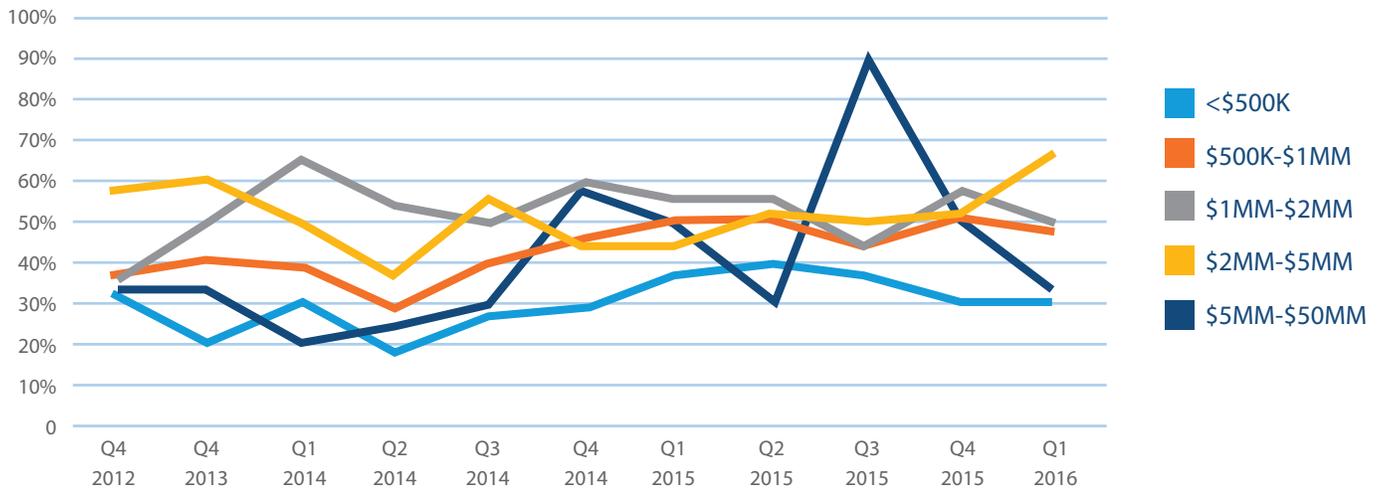


Figure 5: Top 3 Reasons Sellers Went to Market

Transaction Size	#1	#2	#3
<\$500K	Retirement	Burnout	New Opportunity
\$500K - \$1MM	Retirement	Burnout	New Opportunity
\$1MM - \$2MM	Retirement	Burnout, New Opportunity (tied)	
\$2MM - \$5MM	Retirement	Burnout	Family Issues
\$5MM - \$50MM	Retirement	Family Issues	Recapitalization

Looking back year over year, advisors saw an increase in new clients across all sectors, with the strongest growth in the \$2MM-\$5MM sector. Meanwhile, optimism for new client engagements remains strong, at 3.6 or above for all market sectors.

Figure 6: Common Multiple Range

	Q1 2016	Q1 2015	Q1 2014
<\$500K	3.5	3.0	3.2
\$500K - \$1MM	3.7	3.3	2.8
\$1MM - \$2MM	3.6	3.3	2.5
\$2MM - \$5MM	3.7	3.2	2.9
\$5MM - \$50MM	3.8	3.5	2.6

## WHO HAS THE ADVANTAGE: BUYERS OR SELLERS?

While sellers still have a clear advantage in the lower middle market, advisor confidence is showing signs of decline. Year over year, advisors were less likely to report a seller's market sentiment for this sector.

Figure 7: Seller's Market Sentiment Trending Down in LMM

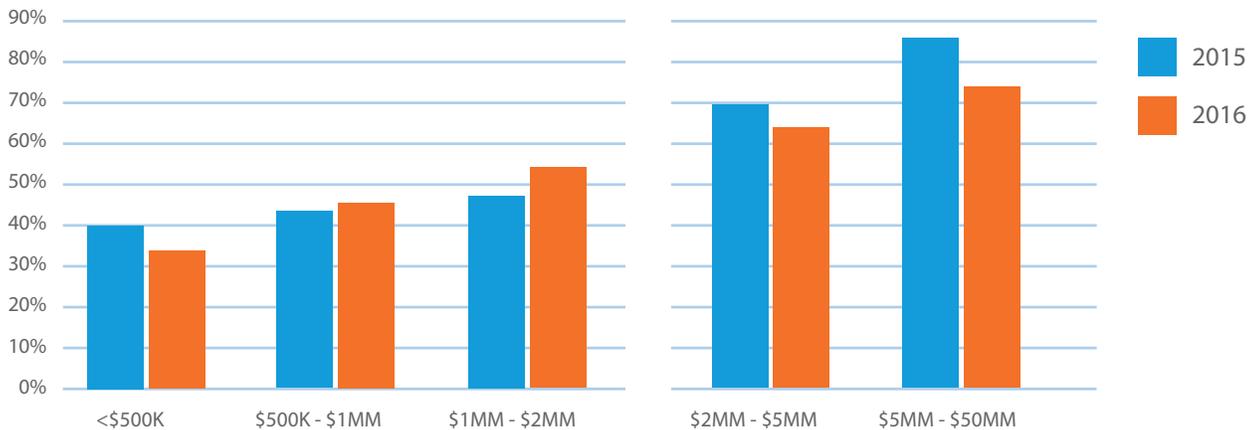
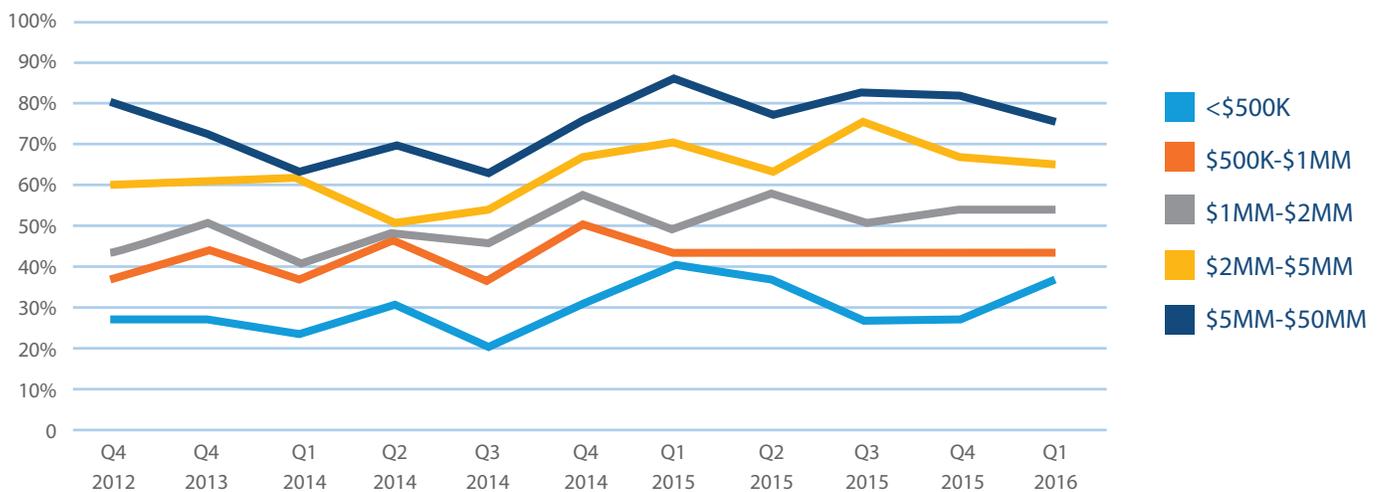


Figure 8: Seller's Market Sentiment, Historic Trends



*“We can see that multiples are still strong across every sector, so I think the decline in seller market sentiment has more to do with the aging bull market than actual market performance,” says Steve Cobb, Senior Partner, Legacy Business Advisors. “The current bull market has passed its seven-year birthday, making it the third longest bull market in history. If we’re seeing a downtick in optimism, it’s because history tells us a decline is coming.”*

## WHERE ARE BUSINESS VALUES TRENDING?

Main Street valuation multiples haven't seen much change over the last seven quarters. Four out of five sectors stayed the same or increased from a multiples standpoint. The lower middle market is the bright spot in this quarter's survey, recording a record 5.5 multiple of EBITDA, the best we've seen over the last seven quarters.

Figure 9: Median Multiple Remain Stable

	2016	2015				2014	
	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Median Multiple Paid (SDE)							
<\$500K	2	2	2	2	2	2	2
\$500K - \$1MM	2.8	2.5	2.5	2.5	2.7	2.9	2.5
\$1MM - \$2MM	3	3.3	2.8	3	3.3	3	3.3
Median Multiple Paid (EBITDA)							
\$2MM - \$5MM	4	4	4	4	4.5	4.6	4
\$5MM - \$50MM	5.5	5.1	5.3	5	4.9	5	5.1

Figure 10: Common Multiple Range

Common Multiple Range (SDE)	
<\$500K	62% between 1.5-2.5
\$500K - \$1MM	70% between 2.5-3.5
\$1MM - \$2MM	67% between 2.5-3.5
Common Multiple Range (EBITDA)	
\$2MM - \$5MM	63% between 2.75-4.75
\$5MM - \$50MM	74% between 3.5-5.75

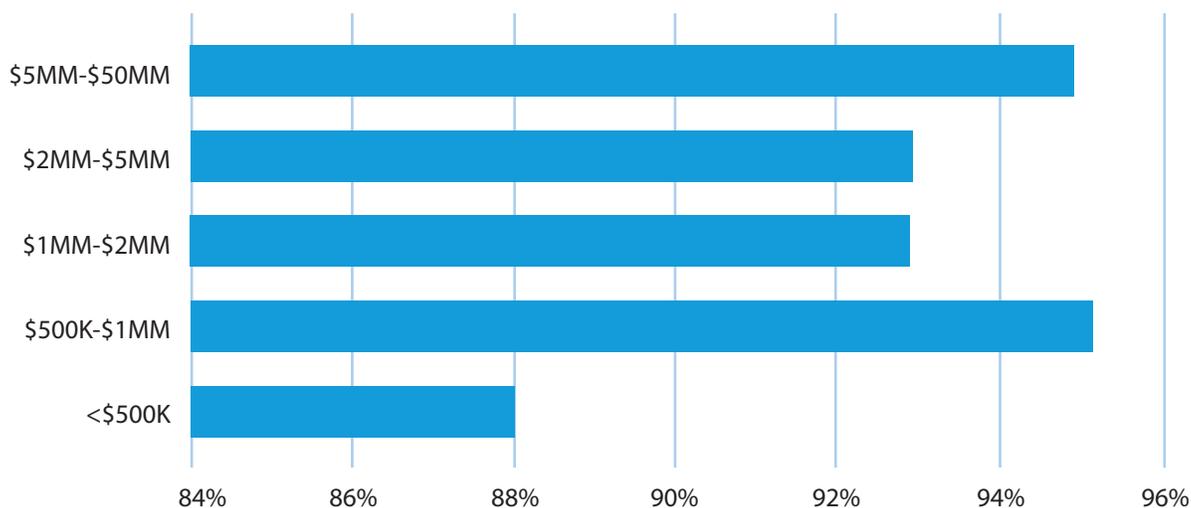
Figure 11: Deal Size Includes Most Common Multiple Type

Deal Size	Most Common Multiple Type
<\$500K	SDE w/o working capital
\$500K - \$1MM	SDE w/o working capital
\$1MM - \$2MM	SDE w/o working capital
\$2MM - \$5MM	EBITDA incl. working capital
\$5MM - \$50MM	EBITDA w/o working capital

\* SDE Sellers Discretionary Earning

When averaged, Main Street businesses sold for approximately 92% of their asking price in Q1 2016. This is a slight improvement over the previous quarter. Meanwhile, businesses in the lower middle market—which typically aren't marketed with an asking price—received 94% of the internal benchmark set by the advisor and seller. While still strong, this is a five percentage point drop over Q4 2015.

Figure 12: Final Price Realized vs. Asking Price



*“In the \$5 million-to-\$50 million category, multiples are up but benchmark-to-sale-price is down. This is tied to expectations the advisor set prior to taking on the engagement,” says David Ryan, President of Upton Financial Group. “It takes about a year to sell a company that size, so we can see that optimism was clearly at a peak when those opportunities entered the market.”*

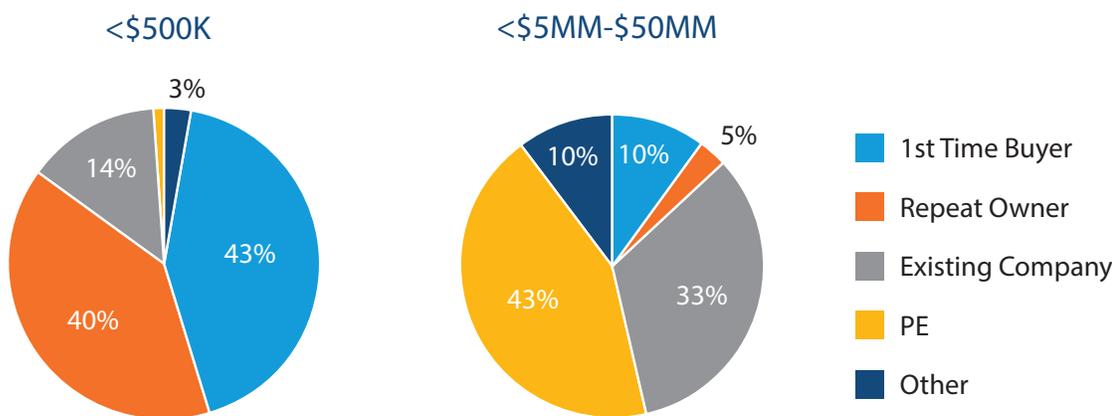
*“As ever, there’s a real risk in overpricing your business, whether you publish an asking price or not,” says Joe Lindsey, CBI, M&A, JLC, Inc and M&A Source Chair. “We always tell sellers to stay the course, but there’s inevitably some kind of stepping back after a business is listed. When people set their price too high the business sits on the market and sellers become fatigued. Inevitably performance declines.”*

*“If we take a \$500,000 EBITDA company and it sells for 4x multiple, that gets you \$2 million,” Lindsey continues. “But let’s say EBITDA drops to \$400,000 and multiples drop to 3x with a market turn. Now that same business nets a purchase price of \$1.2 million because it languished on the market too long.”*

### KNOW YOUR BUYER

In the smallest deal category (businesses valued at <\$500K) first time buyers accounted for the largest buyer segment. In the largest deal category (businesses valued between \$5 million to \$50 million) private equity made up the largest buyer group. Individual buyers accounted for only 15% (10% first time buyers, 5% repeat owners) of the larger sector.

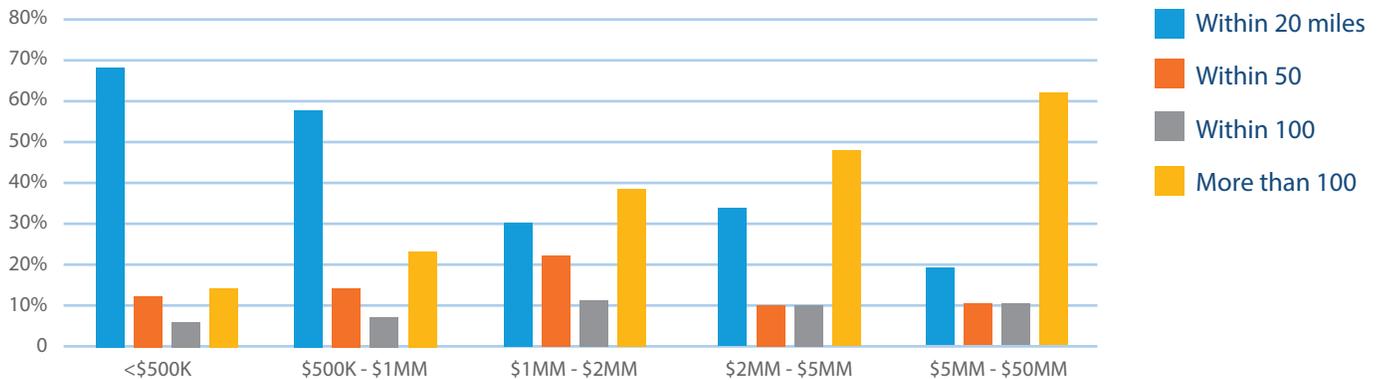
Figure 13: Buyer Comparison by Smallest/Largest Market Sectors



### WHERE DO THEY COME FROM?

As deal size increases, buyers are sourced from a wider geographic area. Yet highly localized buyers (within 20 miles) remain a key buyer pool. Across every sector, buyers are likely to come from within 20 miles or outside 100 miles than any distance in between.

Figure 14: Buyer Location (in miles - relative to seller)



*“The larger the company, the more likely your buyer will come from farther away, and vice versa,” says Angelica Michail, Sunbelt Business Brokers Pasadena, CBI. “Use an advisor who understands those trends and has the marketing know-how and resources to reach your likely targets.”*

### WHAT MOTIVATES THEM?

Buyers in the Main Street market are most often motivated by a desire to buy a job. That is, the buyer is looking to leave corporate America and be active fulltime in the business. Buyers in the lower middle market are more often expanding an existing business through a horizontal or vertical add-on.

Figure 15: Buyer Motivation Shifts with Transaction Size

	Buying a Job	Growing an Existing Business
<\$500K	51%	29%
\$500K - \$1MM	35%	36%
\$1MM - \$2MM	22%	43%
\$2MM - \$5MM	14%	67%
\$5MM - \$50MM	14%	43%

### WHAT INDUSTRIES ARE HOT?

In the Main Street sector, restaurants led, representing 22% of all reported deals in that sector, followed by personal services at 18%, and consumer goods at 13%. Manufacturing led in the lower middle market again (as it did in Q4 2015), representing 37% of all reported deals in that sector.

Figure 16: Top Three Industries by Market

	Main Street	Lower Middle Market
#1	Restaurants	Manufacturing
#2	Services – Personal	Consumer Goods/Retail and Construction/Engineering (tie)
#3	Consumer Goods/Retail	

## HOW LONG DOES IT TAKE TO COMPLETE A DEAL?

The average time to close has stayed relatively flat, averaging 6.5 months in the Main Street market and 9 months in the lower middle market. Of that timetable, roughly 60 to 90 days is spent in due diligence, after the seller accepts a letter of intent.

Figure 17: Median Time to Close

	Months to Close	Months from LOI to Close
<\$500K	6.5	2
\$500K - \$1MM	6	3
\$1MM - \$2MM	7	3
\$2MM - \$5MM	10	4
\$5MM - \$50MM	8	3

*“The LOI to close timeframe is largely determined by the preparation done by a seller and their advisor,” says George Hicks, The M&A Brokers, CBB, CBI. “A good advisor will provide a timely response to questions or concerns as they come up, but a successful, seasoned M&A advisor will anticipate buyer questions before you even go to market. A drawn out due diligence phase has killed many a deal. The more work you can do up front, the better the chance the owner will have of selling their business.”*

## **ABOUT PEPPERDINE UNIVERSITY GRAZIADIO SCHOOL OF BUSINESS AND MANAGEMENT**

A leader in cultivating entrepreneurship and digital innovation, the Pepperdine University Graziadio School of Business and Management focuses on the real-world application of MBA-level business concepts. The Graziadio School provides student-focused, globally-oriented education through part-time, full-time, and executive MBA programs at our five Southern California locations and at our Silicon Valley, Santa Barbara, and Dallas campuses as well as through online and hybrid formats. In addition, the Graziadio School offers a variety of master of science programs, a bachelor of science in management degree-completion program, and the Presidents and Key Executives MBA, as well as executive education certificate programs. Follow the Graziadio School on Facebook, Twitter at @GraziadioSchool, 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 (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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