

2Q15

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

MARKETPULSE

QUARTERLY SURVEY REPORT

SECOND QUARTER 2015



THE IBBA AND M&A SOURCE MARKET PULSE SURVEY REPORT Q2 2015

MAIN STREET

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 Q2 2015 survey was completed by 249 business brokers and M&A advisors, representing 37 states. More than half of the respondents (60%) had at least 10 years of experience.

Except when noted, this report represents the Main Street portion of the report, highlighting IBBA members active in this sector.

Figure 1: Market Segments Studied

| Main Street | | |
|------------------|----------------|---------------|
| Less than \$500K | \$500K - \$1MM | \$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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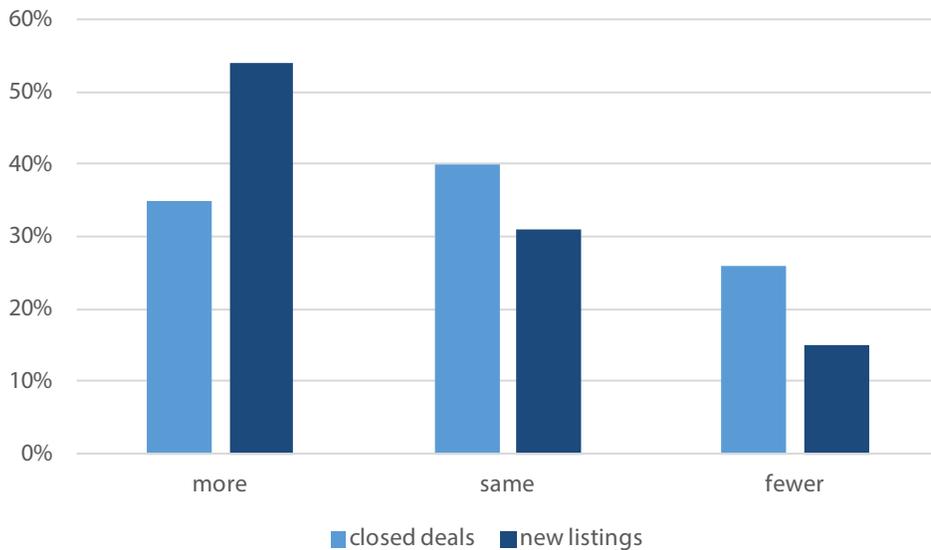
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KEY FINDINGS:

Even though 2014 was a very good year for most brokers, 2015 is starting off even stronger with 54% of respondents indicating client growth is on pace to exceed 2014. Likewise, 36% of brokers say they've closed more deals in the first half of 2015 than the same time period last year, while only 26% reporting a decline.

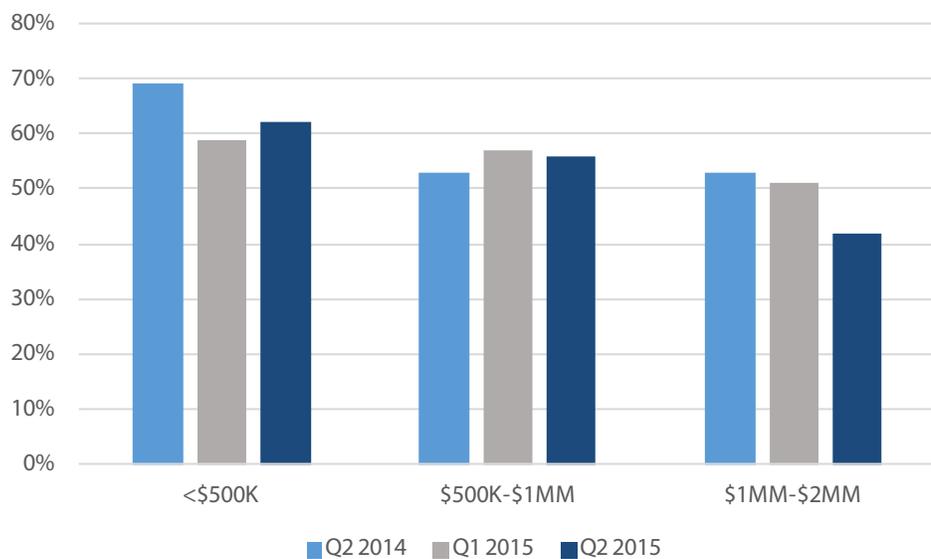
Figure 2: Client Growth and Deal Closures, Compared to First Half of 2014



MARKET ADVANTAGE AND VALUATIONS

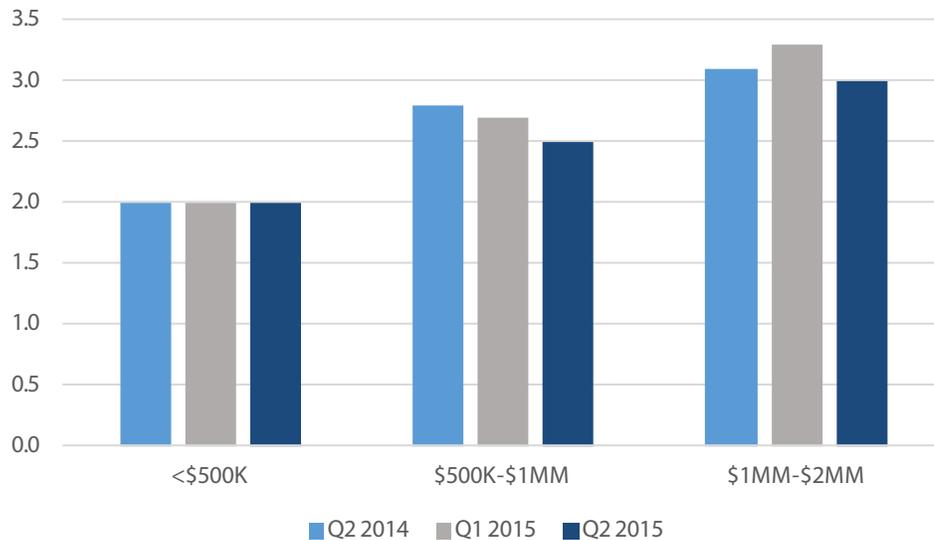
The smaller the business, the more likely advisors are to report a buyer's market. As business size grows, the buyer advantage declines. In fact, as deal size grows to \$1MM and higher, advisors are now pointing to slightly more of a seller's market.

Figure 3: Advisors Indicating a Buyer's Market



A shrinking buyer advantage should mean climbing valuations. However, valuations for Main Street may be on the decline, with two sectors showing year-over-year decreases. Valuations for the smallest market sector have remained consistent. Of note, multiples did increase as deal size grew.

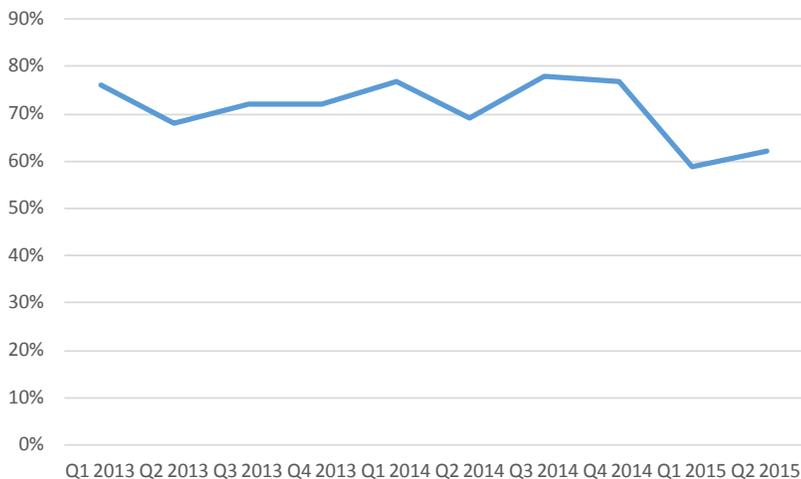
Figure 4: Median SDE Multiple Paid



Over the last two years, brokers have consistently judged Main Street’s smallest sector to be a buyer’s market. Q1 2015 received the weakest buyer’s market rating (at 59% of survey respondents), indicating sellers had more leverage than normal last quarter. Q2 shows a moderate shift back to the buyer’s favor, although conditions are still more favorable than they were throughout all of 2013 and 2014.

During the same time period, from Q1 2013 to Q2 2015, valuations in the <\$500K sector stayed constant, with a median Seller’s Discretionary Earnings (SDE) multiple of 2.0 in each quarter.

Figure 5: Brokers Rating <\$500K Sector as a Buyer’s Market



“As businesses get larger, they typically face less competition, a key factor that can push a business toward a seller’s market,” says Lisa Riley, LINK Business-Phx, CBI. “Meanwhile, most times there is a glut of businesses in the smallest market segment. Thus, even though the market is active, buyers are going to maintain the advantage and multiples paid won’t fluctuate much.”

Figure 6: SDE Common Multiple Range, Q2, 2015

| | Median | Range |
|--------------|--------|-----------------------|
| <\$500K | 2.0 | 62% between 1.5-2.5 |
| \$500K-\$1MM | 2.5 | 53% between 1.75-2.5 |
| \$1MM-\$2MM | 3.0 | 64% between 2.75-3.25 |

Figure 7: SDE Common Multiple Range, Q1 2015

| | Median | Range |
|--------------|--------|-----------------------|
| <\$500K | 2.0 | 65% between 1.75-3.00 |
| \$500K-\$1MM | 2.7 | 76% between 2.0-3.00 |
| \$1MM-\$2MM | 3.3 | 54% between 2.75-3.75 |

“Although Main Street multiples are still relatively strong overall, it looks as though the market may have peaked in the last half of 2014 or early 2015,” continued Riley. “It’s still too early to tell, but the next quarter or two should help clarify these trends.”

FINANCING

Advisors saw some improvement in the lending climate in Q2, with more than a quarter (28%) indicating that financing deals was easier. Only 11% said financing deals was harder.

Seller financing represented 11-12% of deal structure, showing slight declines in most sectors when compared to Q1 this year.

“More buyers are taking advantage of SBA loans, which helps reduce the risk to local banks and extends the amortization period for buyers,” Bernie Siegel, Murphy Business Eastern Pennsylvania, CBI explains. “As a result, it’s easier to get deals financed with lower amounts of seller financing. The SBA will often amortize a loan over seven or 10 years, versus conventional banks at five years, reducing the buyer’s monthly payments. This extended financing also allows buyers to pay more for a business without exceeding reasonable cash flow to debt service ratios.”

“As a note, the SBA actually maxed out its \$18.75 billion funding cap, more than two months before the end of the federal fiscal year. Congress approved additional funds so buyers and sellers don’t have to wait until October 1 to get financing,” Siegel says. “Without the SBA, sellers would need to contribute a great deal more financing to get these Main Street deals done.”

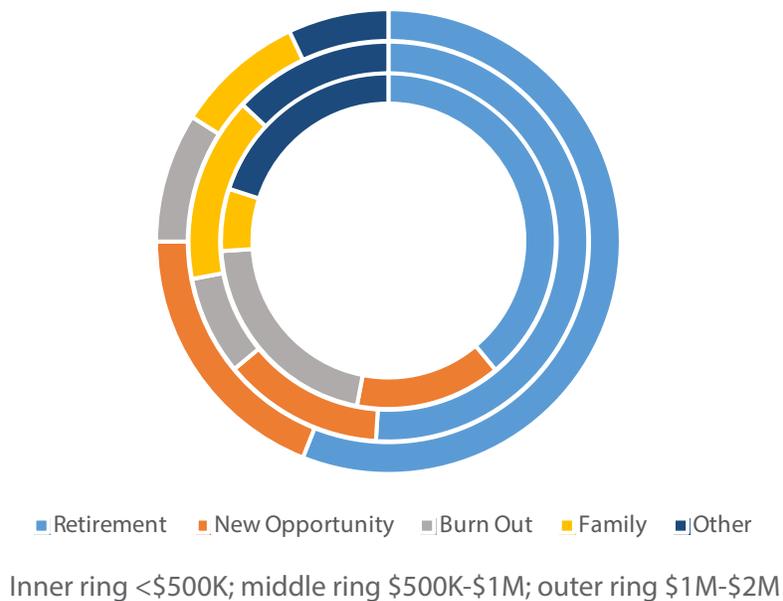
Figure 8: Percent of Total Deal Value in Seller Financing

| | Q2 2014 | Q1 2015 | Q2 2015 |
|--------------|---------|---------|---------|
| <\$500K | 13% | 10% | 12% |
| \$500K-\$1MM | 18% | 17% | 11% |
| \$1MM-\$2MM | 9% | 17% | 12% |

REASON TO SELL

Retirement continues to lead as the number one reason to sell across all Main Street sectors, followed by new opportunities, burnout, and family issues.

Figure 9: Reason for Seller to Go to Market



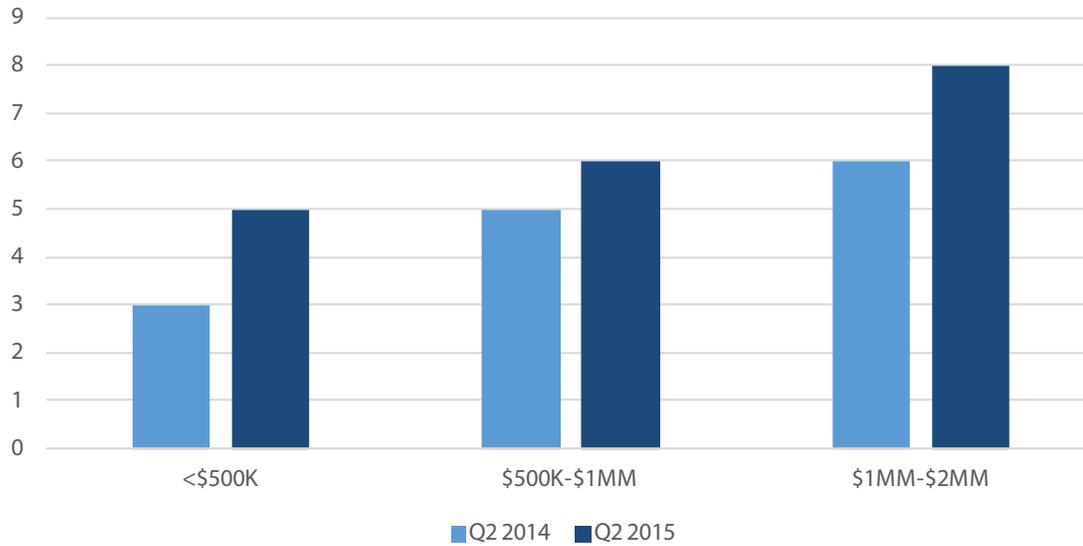
| | <\$500 | \$500-\$1M | \$1M-\$2M |
|-----------------|--------|------------|-----------|
| Retirement | 39% | 51% | 56% |
| Burn Out | 21% | 8% | 9% |
| Family Issues | 6% | 15% | 9% |
| New Opportunity | 14% | 13% | 19% |

MEDIAN TIME TO CLOSE

Year over year, the average time to close rose for every Main Street sector, jumping by as much as two months for businesses in both the <\$500K and the \$1MM-\$2MM sectors.

“Brokers have seen the due diligence process take a bit longer,” says Cress Diglio, Transworld Business Advisors, CBI. “And as more deals are funded using the SBA, closing dates get extended due to the additional paperwork and oversight required compared to getting a conventional loan.”

Figure 10: Median Months to Close



HOT INDUSTRY

Restaurants, personal services, and business services all held leading positions in the Main Street sector this quarter.

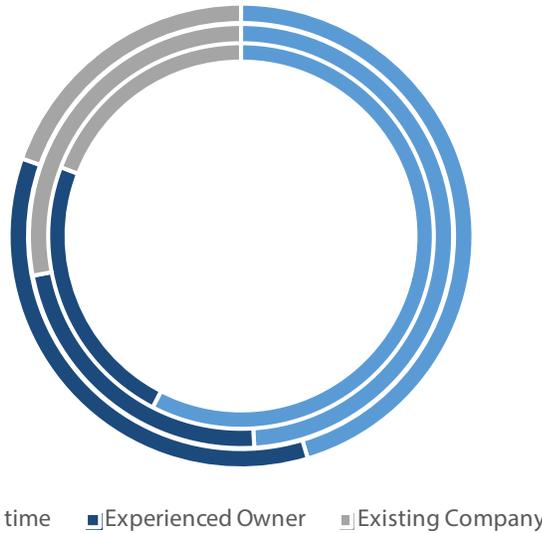
Figure 11: Hot Industries

| | | | |
|--------------|-----------------------|----------------------------|---------------------------|
| <\$500K | Restaurants 24% | Personal Services 19% | Business Services 13% |
| \$500K-\$1MM | Personal Services 15% | Wholesale/Distribution 15% | Restaurant 12% |
| \$1MM-\$2MM | Business Services 17% | Manufacturing 14% | Consumer Goods/Retail 14% |

BUYER TYPE

First time buyers led the Main Street market, followed by previous business owners and existing companies/strategic buyers.

Figure 12: Buyer Type



Inner ring <\$500K; middle ring \$500K-\$1M; outer ring \$1M-\$2M

| | | | |
|--------------|--------------|-----------------------|-----------------------|
| <\$500K | 1st time 57% | Experienced owner 23% | Existing company 19% |
| \$500K-\$1MM | 1st time 49% | Existing company 28% | Experienced owner 23% |
| \$1MM-\$2MM | 1st time 44% | Experienced owner 34% | Existing company 19% |

Consistent with individual buyers as the leading buyer type, survey respondents reported that Main Street buyers are most likely seeking to buy a job. Horizontal add-ons were the second most commonly cited buyer motivation, followed by better ROI than other investments.

Figure 13: Buyer Motivation

| | | | |
|--------------|------------------|-----------------------|---------------------|
| <\$500K | Buying a Job 53% | Horizontal Add-On 18% | Better ROI 10% |
| \$500K-\$1MM | Buying a Job 54% | Horizontal Add-On 21% | Vertical Add-on 13% |
| \$1MM-\$2MM | Buying a Job 38% | Horizontal Add-On 19% | Better ROI 19% |

Figure 14: Buyer Location (Relative to Seller)

| | Within 20 miles | Within 50 miles | Within 100 miles | >100 miles |
|--------------|-----------------|-----------------|------------------|------------|
| <\$500K | 54% | 15% | 9% | 21% |
| \$500K-\$1MM | 33% | 33% | 13% | 21% |
| \$1MM-\$2MM | 34% | 22% | 3% | 41% |

“Note to seller,” says Mark Wood, VMW Business Brokers, Inc, CBI, “a good rule of thumb to find your buyer is the smaller the business, the closer the buyer. In fact, in the smallest sector, for businesses valued at \$500,000 or less, the buyer will most likely come from your hometown or thereabouts.”

NEW CLIENTS

All market sectors showed a growth in new clients, with a mean of 3.3 or better (on a five-point scale) for all deals valued at \$500K and above. Compared to last quarter, advisors saw an uptick in clients in most Main Street sectors, with the \$1MM to \$2MM sector experiencing the largest jump.

Meanwhile, optimism for new client engagements remains consistent with last quarter and is near peak since the survey began.

“Remember, we still have about 10,000 Boomers retiring every single day. We can expect new client growth will continue, as long as market conditions are favorable,” says Marcie Woolworth, MRW & Associates, CBI. “Brokers are feeling encouraged right now, but all bets are off if the economic bubble bursts.”

Figure 15: Mean Increase in New Clients (5-point scale)

| | Q2 2015 | Q1 2015 |
|--------------|---------|---------|
| <\$500K | 3.3 | 3.0 |
| \$500K-\$1MM | 3.4 | 3.3 |
| \$1MM-\$2MM | 4.0 | 3.3 |

Figure 16: Expectations for New Clients in Q3 2015

| | |
|--------------|-----|
| <\$500K | 3.6 |
| \$500K-\$1MM | 3.7 |
| \$1MM-\$2MM | 3.6 |

LOWER MIDDLE MARKET

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This report represents the lower middle market portion of the report, highlighting M&A Source members active in this sector.

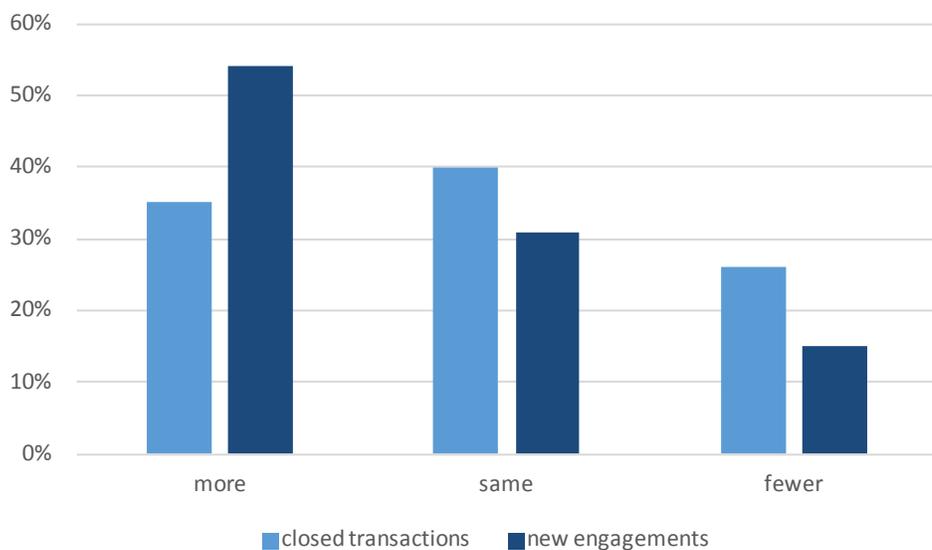
Figure 1: Market Segments Studied

| Lower Middle Market | |
|---------------------|--------------|
| \$2MM-\$5MM | \$5MM-\$50MM |

KEY FINDINGS:

Even though 2014 was a very good year for most M&A advisors, 2015 is starting off even stronger with 54% of respondents indicating client growth is on pace to exceed 2014. Likewise, 36% of advisors say they've closed more transactions in the first half of 2015 than the same time period last year, while only 26% report a decline.

Figure 2: Client Growth and Closures, Compared to First Half of 2014

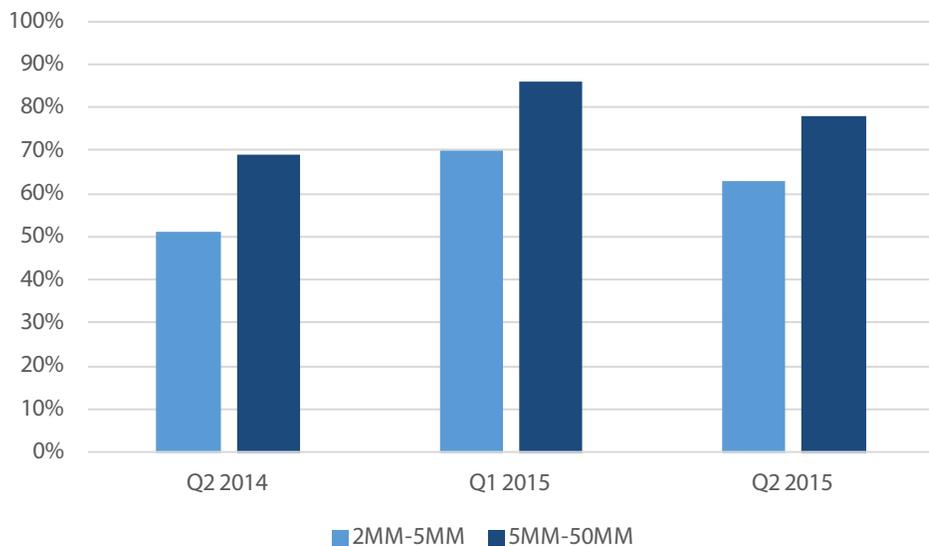


MARKET ADVANTAGE AND VALUATIONS

The lower middle market continues to present as a strong seller's market. Year-over-year, the strength of that sentiment has increased significantly. However, advisors are indicating a slight dip since market peak in Q1 this year.

"The large supply of well-financed buyers still significantly outweighs the number of quality sellers in the current market," says, Joe Lindsey, JLC, Inc, M&AMI.

Figure 3: Advisors Indicating a Seller's Market



Compared to Q1, transaction values shrank 0.5 points for businesses valued between \$2MM-\$5MM but grew 0.1 points for businesses valued between \$5MM-\$50MM. Year-over-year, however, multiples show a slightly more marked decline.

Figure 4: Median EBITDA Multiple Paid

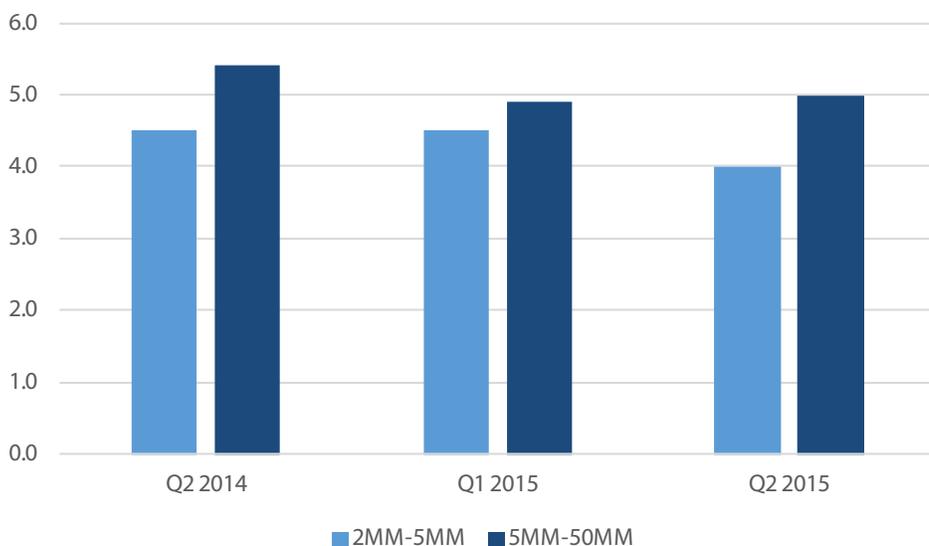


Figure 5: Common Multiple Range, Q2 2015

| | Median | Range |
|--------------|--------|-----------------|
| \$2MM-\$5MM | 4.0 | 66% 3.25 to 4.5 |
| \$5MM-\$50MM | 5.0 | 62% 4.5-65 |

“For those business owners who are waiting to sell by trying to time the M&A market to maximize value, it would appear we are nearing the market peak. While the market remains strong for sellers, most M&A advisors do not believe that multiples will get much better before the next economic bubble bursts,” says David Ryan, President Upton Financial Group. “If you want to get top dollar in the next two years, you should seriously consider talking to an advisor now. In the 1 to 5MM range, more than twice as many transactions were completed for the 12 months ending June 2015 compared to the same time period for 2014.”

SELLER FINANCING

Advisors saw some easing in the lending climate in Q2, with more than a quarter (28%) indicating that financing deals was easier. Only 11% said financing deals was harder.

But despite the better lending climate, seller financing increased in Q2 2015.

Figure 6: Percent of Total Deal Value in Seller Financing and Earn Out

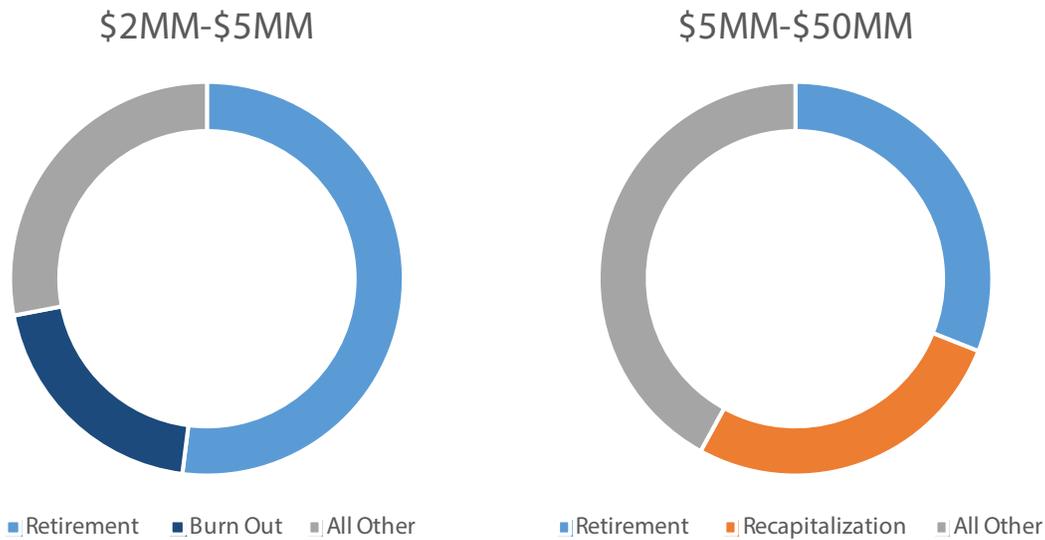
| | Seller Financing | | | Earn Out | | |
|--------------|------------------|---------|---------|----------|---------|---------|
| | Q2 2014 | Q1 2015 | Q2 2015 | Q2 2014 | Q1 2015 | Q2 2015 |
| \$2MM-\$5MM | 10% | 7% | 18% | 1% | 4% | 12% |
| \$5MM-\$50MM | 0 | 5% | 13% | 27% | 26% | 4% |

“Even though seller financing grew by about eight percentage points, we saw a sizable drop in earn outs in the largest market sector,” says Jim Afinowich, Fox & Fin Financial Group, M&AMI. “With a little bit more aggressive financing in today’s marketplace, the valuation gap between the buyer and the seller is being filled primarily by seller financing. This deal structure offers a more secure position for the seller due to today’s seller’s market.”

REASON TO SELL

Retirement continues to lead as the number one reason to sell in the lower middle market, accounting for 52% of new engagements in the \$2MM-\$5MM sector and 31% in the \$5MM-\$50MM sector. Retirement was followed by burnout at 20% and recapitalization at 27% in each category, respectively.

Figure 7: Reason for Seller to Go to Market

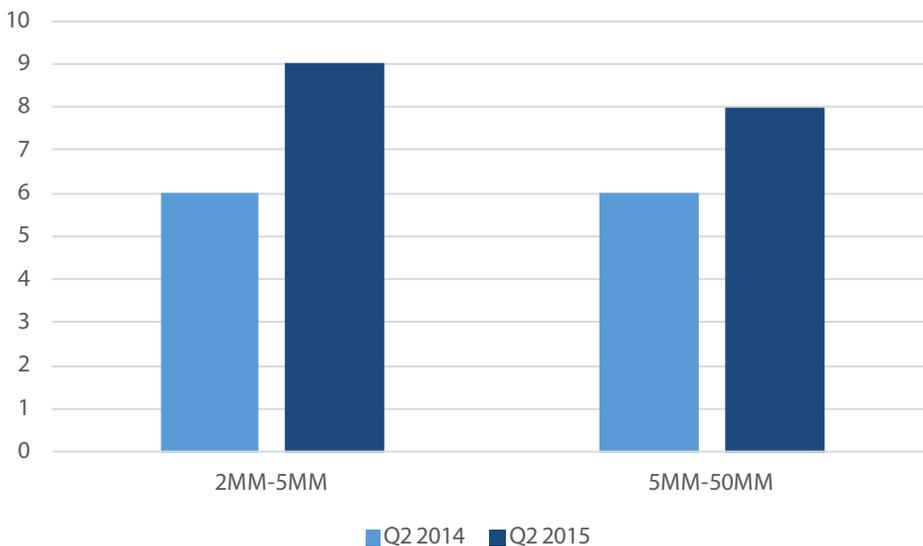


TIME TO CLOSE

The average time to close has increased in the lower middle market, coming in at 9 months in the \$2MM-\$5MM sector and 8 months in the \$5MM to \$50MM sector.

“Deals are getting done, but sellers need to be prepared for longer due diligence processes,” says Steve Wain, Calder Associates, Inc, M&AMI. “That’s shining a spotlight on sellers who have the right advisors and go into the process prepared versus sellers who go in blind. As we all know, time kills all deals, so any delay is risky.”

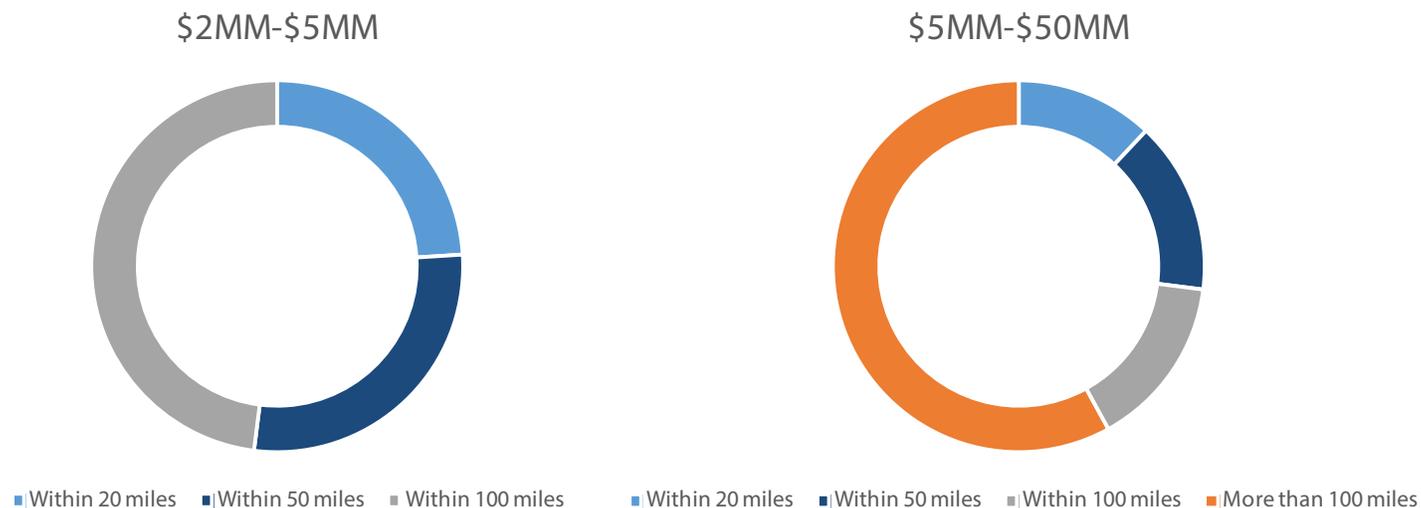
Figure 8: Median Months to Close



BUYER LOCATION

The larger the deal, the farther buyers will travel. In the \$2MM-\$5MM sector, the majority of buyers (48%) were located within a 100 mile radius. But in the \$5MM-\$50MM sector, most buyers (58%) were located more than 100 miles away from the seller.

Figure 9: Buyer Location (Relative to Seller)



“It’s critical to use an advisor with the right network and resources,” says Craig Everett, PhD, Pepperdine Private Capital Markets Project, Director. “If not, you could be marketing your business to the wrong buyers and either reducing the chance of selling your business or leaving substantial money on the table.”

BUYER TYPE

Buyers in the \$5MM-\$50MM sector were most likely to be an existing company/strategic buyer or private equity firm. However, individual buyers were very active in the \$2MM-\$5MM sector.

Figure 10: Buyer Type

| | | | |
|--------------|----------------------|-----------------------|----------------------|
| \$2MM-\$5MM | Existing Company 36% | Experienced Owner 24% | First Time Buyer 20% |
| \$5MM-\$50MM | Existing Company 38% | PE Platform 38% | PE Add-on 12% |

“Companies already had strong balance sheets, but improving lending conditions means it’s even easier for them to make acquisitions,” says Gary Papay, IBG Business, M&AMI. “Many existing companies see less risk in growing their top and bottom line through acquisition, rather than growing organically.”

HOT INDUSTRY

Manufacturing and wholesale/distribution ranked among the leading industries for the lower middle market this sector. Construction/engineering and business services also held leading positions.

Figure 11: Hot Industries

| | | |
|--------------|--|--|
| \$2MM-\$5MM | Manufacturing 24% & Construction/Engineering 24% | Wholesale/distribution 16% |
| \$5MM-\$50MM | Manufacturing 35% | Business Services 15% & Wholesale/distribution 15% |

NEW CLIENTS

Advisors reported that overall client engagements remained relatively stable, increasing slightly with a mean of 3.2 or 3.3 on a five-point scale. Meanwhile, optimism for new client engagements remains consistent with last quarter and is near peak since the survey began.

“More Baby Boomers are making the tough emotional decision to sell their business and part with their ‘baby.’ However, the majority of Boomers still haven’t made the move—many because they can’t separate their personal identity from that of their business,” says Scott Bushkie Cornerstone Business Services, M&AMI. “In the near future, we may see a glut of Boomers coming to the market all at once. And if that happens, valuations are likely to decline due to an oversupply of businesses on the market.”

“Business owners who sell now are ahead of the curve, earning higher values due to less market competition,” Bushkie continued.

Figure 12: Mean Increase in New Clients (5-point scale)

| | Q2 2015 | Q1 2015 |
|--------------|---------|---------|
| \$2MM-\$5MM | 3.2 | 3.2 |
| \$5MM-\$50MM | 3.3 | 3.5 |

Figure 13: Expectations for New Clients in Q3 2015

| | |
|--------------|-----|
| \$2MM-\$5MM | 3.6 |
| \$5MM-\$50MM | 3.5 |

ABOUT PEPPERDINE UNIVERSITY GRAZIADIO SCHOOL OF BUSINESS AND MANAGEMENT

A leader in cultivating entrepreneurship and digital innovation, the Graziadio School of Business and Management at Pepperdine University 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 six California 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, Presidential and Key Executives MBA and executive education certificate programs.

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.

EARN A CERTIFICATE IN PRIVATE CAPITAL MARKETS



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*.

- Designed for business owners and professionals employed within the finance, banking, investment, mergers and acquisitions, valuation, management consulting, legal, and accounting fields
- Learn in-depth critical analysis and evaluating skills necessary for successfully operating a business within the private capital markets
 - Overview of Private Capital Markets Theory and Sources of Capital
 - The Role of Intermediaries
 - Angel Investments, Venture Capital, and Other Early Stage Financing Sources
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