

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

# MARKET PULSE

QUARTERLY SURVEY REPORT

FIRST QUARTER 2015



# THE IBBA AND M&A SOURCE MARKET PULSE SURVEY REPORT Q1 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 Q1 2015 survey was completed by 231 business brokers and M&A advisors, representing 39 states. More than half of the respondents (57%) 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](mailto:admin@ibba.org) or (888) 686-4222.

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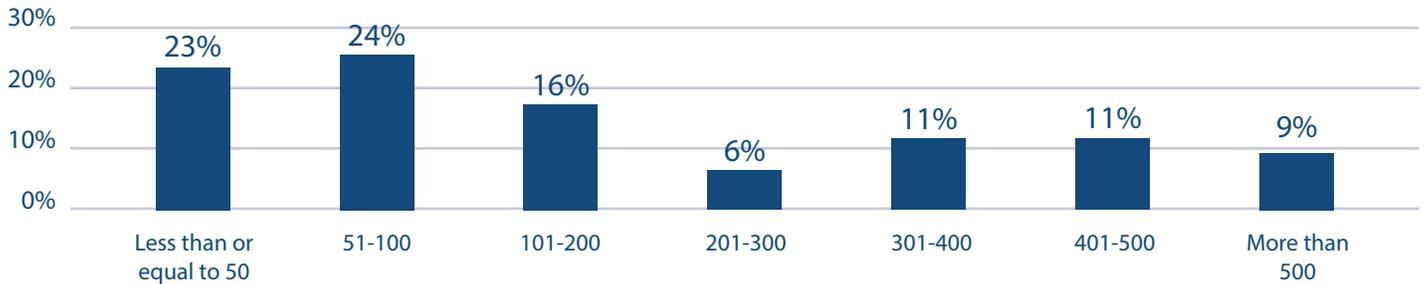
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Research Associate

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## KEY FINDINGS:

New this survey, respondents were asked to estimate the average number of hours they spend to close a deal. Roughly half of the advisors estimated they spend less than 100 hours per deal (23% at less than 50 hours, 24% at 50-100 hours). The other half, however, are putting in significantly more time, ranging from 100 hours to more than 500 hours on average per closure.

Figure 2: Average Hours per Closure\*



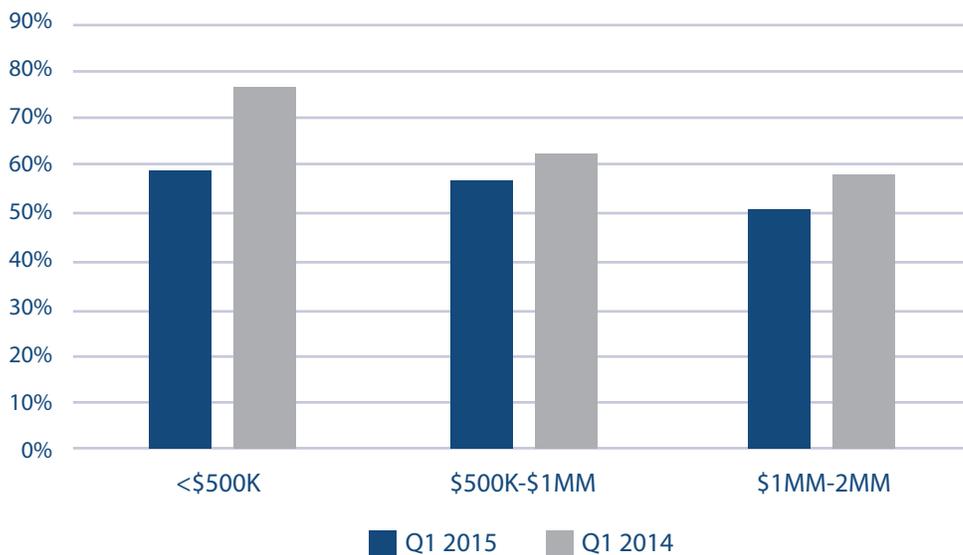
\* results include both Main Street and Lower Middle Market sectors

## BUYER'S MARKET VS SELLER'S MARKET

The majority of advisors are still pointing to a buyer's market in the Main Street sector, but the strength of that sentiment has weakened considerably over a year ago. A year ago, 77% of advisors indicated the smallest deals (under \$500K) faced a buyer's market, but today only 59% feel that way—a record low since the survey began.

Also of note, the trend continues to shift to a seller's market as deal size increases.

Figure 3: Advisors Indicating a Buyer's Market



*“Buyers looking at buying a company in the Main Street market can still maintain advantage when buying a smaller firm, but the market continues to shift towards a seller’s market,” says Lisa Riley, CBI, Principal, LINK Business. “Buyers are losing their leverage as time passes and business size increases. If you’re doing a \$1 million to \$2 million deal, you’re moving into a neutral market.”*

## NEW CLIENTS

All market sectors showed a growth in new clients, with a mean of 3.2 or better (on a five-point scale) for all deals valued at \$500K and above. Looking back year over year, advisors saw a substantial uptick in clients in most Main Street sectors. The \$1MM to \$2MM sector saw the biggest gain with a 0.8 point jump.

Meanwhile, optimism for new client engagements is near its peak since the survey began.

Figure 4: Mean Increase in New Clients (5-point scale)

|              | Q1 2015 | Q1 2014 |
|--------------|---------|---------|
| <\$500K      | 3.0     | 3.2     |
| \$500K-\$1MM | 3.3     | 2.8     |
| \$1MM-\$2MM  | 3.3     | 2.5     |

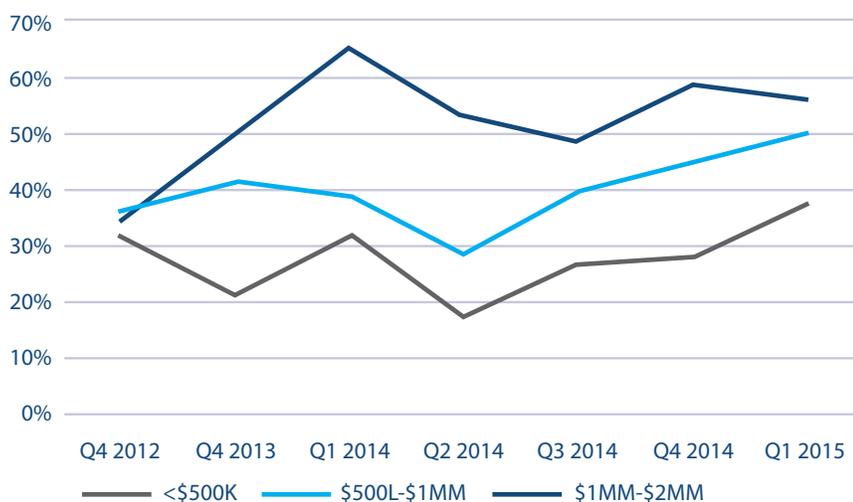
Figure 5: Expectations for New Clients in Q2 2015

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

## REASON TO SELL

Retirement continues to lead as the number one reason to sell across all Main Street sectors. Notably, even though retirement has consistently held the number one spot for several quarters, the trend is still growing. The number of sellers entering the market due to retirement is at the highest levels since the survey started in 2012 for businesses valued up to \$1MM.

Figure 6: Sellers Entering Market for Retirement



*“Statistically, one business owner is turning 65 every minute. Baby Boomers are affecting small business sales on both sides of the equation right now,” said David Ryan, Upton Financial.*

Of note, burnout held on to the number two spot, consistent with Q4 2014.

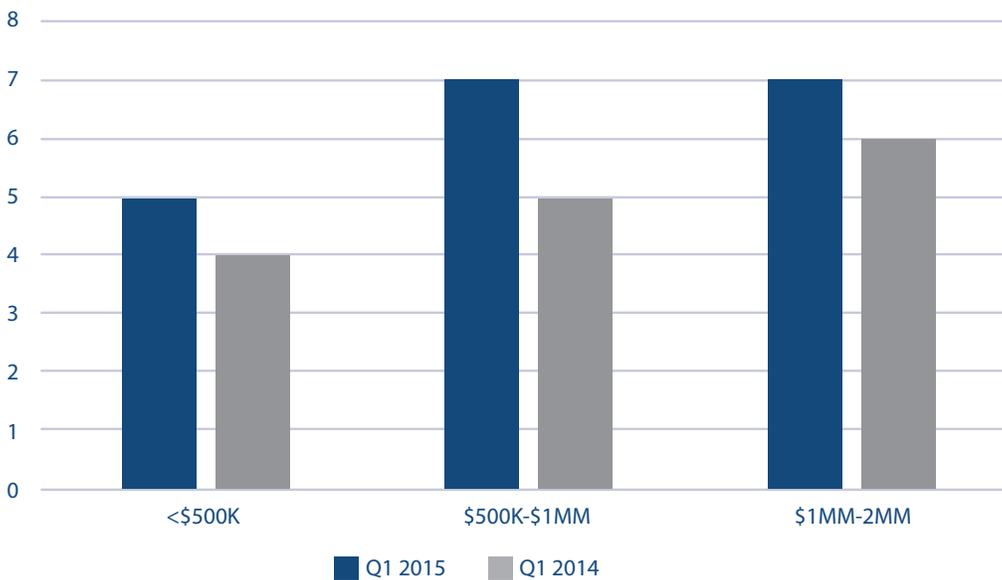
Figure 7: Reason to Sell

| Reason to Sell           | Transaction Size |              |             |
|--------------------------|------------------|--------------|-------------|
|                          | <\$500K          | \$500K-\$1MM | \$1MM-\$2MM |
| Retirement               | 38%              | 50%          | 56%         |
| Burnout                  | 25%              | 17%          | 12%         |
| Family issues/Relocating | 10%              | 10%          | 20%         |

### 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 the \$500K-\$1MM sector. Businesses in the \$500-\$1MM sectors and the \$1MM-\$2MM sectors took seven months to close, on average, this quarter.

Figure 8: Median Months to Close



## DEAL MULTIPLES

As predicted in prior surveys, valuations for Main Street businesses stayed the same or saw a slight increase year over year. In each of the Main Street market sectors, deal multiples remained strongly concentrated within roughly a one point spread. Multiples increased consistently as deal size grew.

Figure 9: Median SDE Multiple Paid

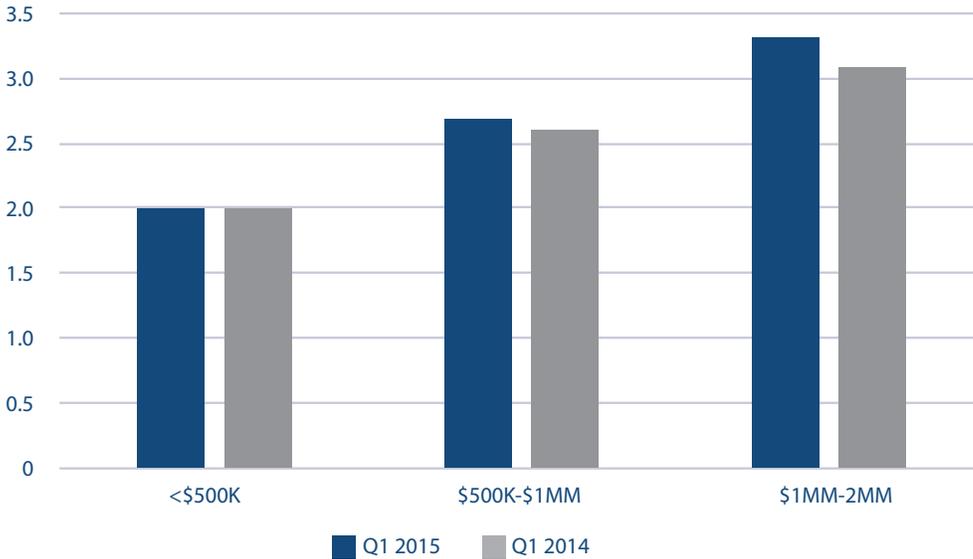


Figure 10: Common Multiple Range

|              | Median SDE | SDE 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 |

*“Businesses that are going to market now are able to take advantage of the confidence in the marketplace, along with low interest rates and more aggressive financing,” said Andrew Rogerson, CBI, Principal, Rogerson Business Services. “It will be interesting to see how rising interest rates affect overall valuations.”*

## SELLER FINANCING

Seller financing decreased in the smallest Main Street sectors but represented a larger percentage of deal structure in the \$1MM-\$2MM sector.

Figure 11: Percent of Total Deal Value in Seller Financing

|              | Q1 2015 | Q1 2014 |
|--------------|---------|---------|
| <\$500K      | 10%     | 17%     |
| \$500K-\$1MM | 17%     | 23%     |
| \$1MM-\$2MM  | 17%     | 12%     |

## HOT INDUSTRY

Business services led the Main Street market, appearing in the number one (or tied for first) spot for the most businesses sold in each sector. Consumer goods and personal services also held leading positions.

Figure 12: Top 3 Main Street Hot Industries

|              |  |                       |                                      |
|--------------|--|-----------------------|--------------------------------------|
| <\$500K      | Business Services 19%  | Personal Services 15% | Consumer Goods 13% / Restaurants 13% |
| \$500K-\$1MM | Business Services 20%  | Consumer Goods 17%    | Mnfg 13% / Personal Services 13%     |
| \$1MM-\$2MM  | Construction, Business Services, Consumer Goods, Wholesale = all 16% |                       |                                      |

## BUYER TYPE

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

Figure 13: Buyer Type

|                   | Transaction Size |              |             |
|-------------------|------------------|--------------|-------------|
|                   | <\$500K          | \$500K-\$1MM | \$1MM-\$2MM |
| 1st Time Buyer    | 46%              | 50%          | 40%         |
| Experienced Owner | 31%              | 23%          | 36%         |
| Existing Company  | 24%              | 27%          | 20%         |

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 and vertical add-ons were the second most commonly cited buyer motivation.

Figure 14: Buyer Motivation

|                   | Transaction Size |              |             |
|-------------------|------------------|--------------|-------------|
|                   | <\$500K          | \$500K-\$1MM | \$1MM-\$2MM |
| Buying a Job      | 51%              | 40%          | 32%         |
| Vertical Add-on   | 13%              | 17%          | 16%         |
| Horizontal Add-On | 17%              | 20%          | 20%         |

Figure 15: Buyer Location (Relative to Seller)

|              | Within 20 miles | Within 50 miles | Within 100 miles | >100 miles |
|--------------|-----------------|-----------------|------------------|------------|
| <\$500K      | 55%             | 11%             | 11%              | 23%        |
| \$500K-\$1MM | 27%             | 40%             | 13%              | 20%        |
| \$1MM-\$2MM  | 20%             | 32%             | 4%               | 44%        |

*“Given the number of individual buyers seeking to buy a job, the number of buyers coming from more than 100 miles away comes as something of a surprise in this sector,” said Craig Everett, Director, Pepperdine Private Capital Markets Project. “We’re seeing Main Street buyers travel longer distances and even relocate in order to secure the right business opportunity.”*

## TERMINATIONS & MISTAKES

Advisors were asked to indicate the top mistakes sellers make that hurt their chances of a sale. The top three mistakes were:

1. Unrealistic expectations
2. Poor financial records
3. Declining business value

*“As we’ve seen in the past, price expectation continues to be the number one issue where buyers and sellers disagree,” said Cress Diglio, CBI, Transworld Business Advisors and IBBA Chair. “But the second biggest hurdle is poor financial records, which goes to the importance of having a good accounting system which provides timely financials.”*

## LOWER MIDDLE MARKET

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 Graziado School of Business and Management at Pepperdine University.

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

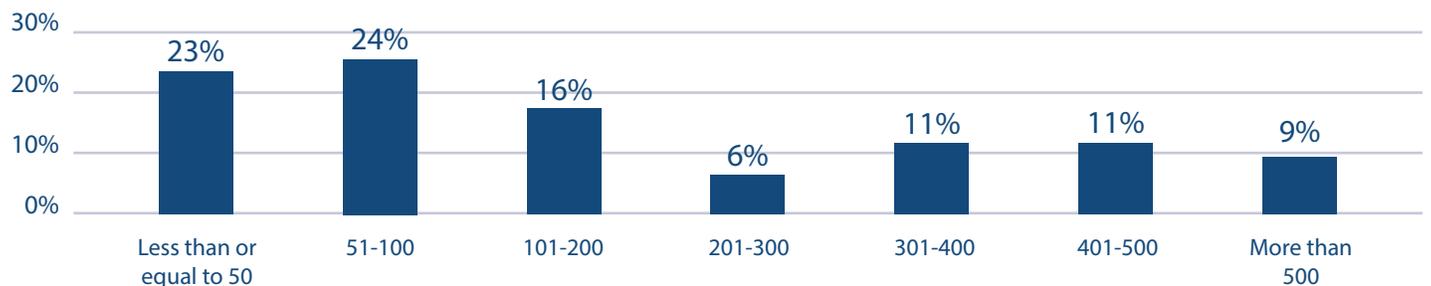
Figure 1: Market Segments Studied

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

### KEY FINDINGS:

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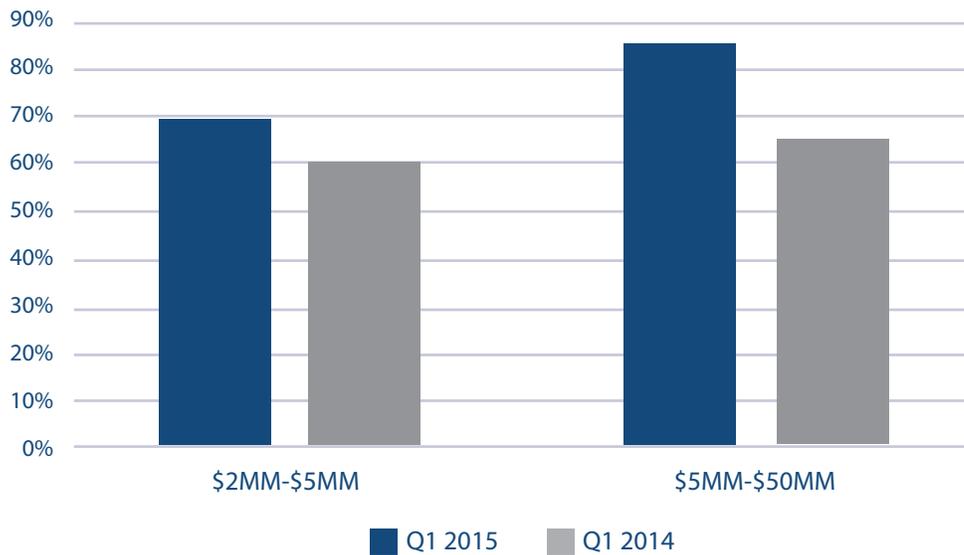


\* results include both Main Street and Lower Middle Market sectors

## BUYER'S MARKET VS SELLER'S MARKET

The lower middle market continues to present as a strong seller's market, and the strength of that sentiment has increased significantly over a year ago. In Q1 2014, 64% of advisors indicated business owners for the largest deals (\$5MM - \$50MM) benefited from a seller's market, and today 86% feel that way—a record high since the survey began.

Figure 3: More Advisors Indicating a Seller's Market



*“According to a well-respected lender, a good credit cycle only lasts between four to seven years in the U.S. Right now we’re at year five, which means that if historic trends continue, this window will stay open for another two years tops,” said Scott Bushkie, President of Cornerstone Business Services.*

*“For the baby boomers and other business owners thinking about selling in the next few years, this is definitely the time to have a conversation with an M&A advisor in your market,” Bushkie continued. “There may be a significant, and limited, opportunity right now to take advantage of the strong seller’s market.”*

## NEW CLIENTS

Looking back year over year, advisors saw a marked increase in new clients. The \$5MM to \$50MM sector saw the biggest gain with a 0.9 point jump in mean on a five-point scale.

Meanwhile, optimism for new client engagements is near its peak since the survey began, at 3.7 for both lower middle market sectors.

Figure 4: Mean Increase in New Clients (5-point scale)

|              | Q1 2015 | Q1 2014 |
|--------------|---------|---------|
| \$2MM-\$5MM  | 3.2     | 2.9     |
| \$5MM-\$50MM | 3.5     | 2.6     |

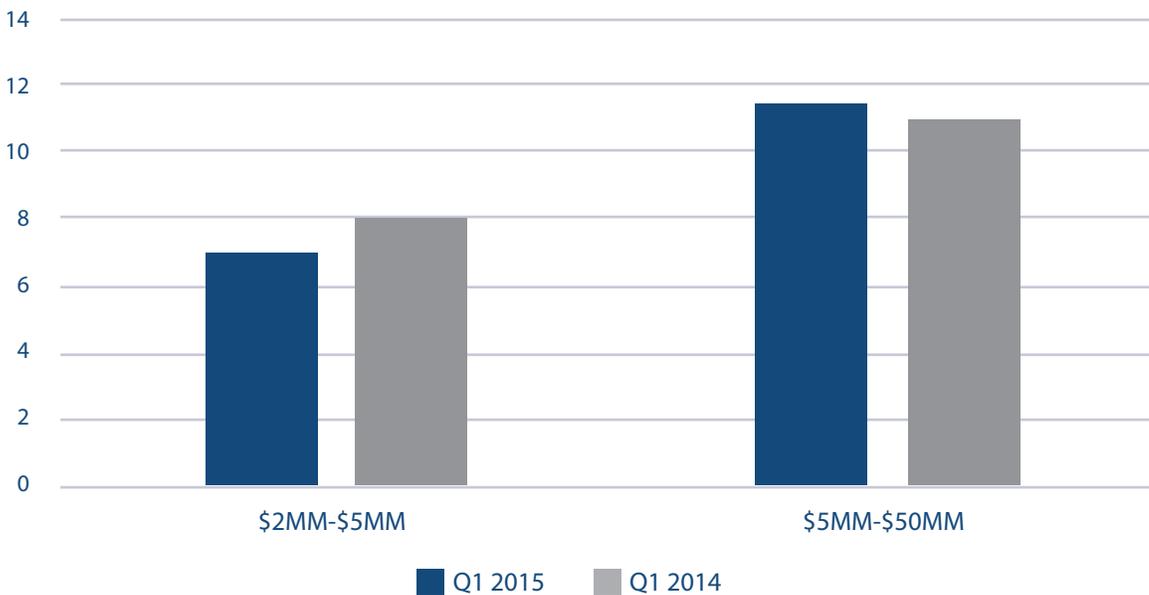
**REASON TO SELL**

Retirement continues to lead as the number one reason to sell across both lower middle market sectors, ranking as 44% and 50% of in the \$2MM-\$5MM sector and the \$5MM-\$50MM sector, respectively.

**TIME TO CLOSE**

The average time to close has stayed relatively flat in the lower middle market, coming in at 7 months in the \$2MM-\$5MM sector and 11.5 months in the \$5MM to \$50MM sector.

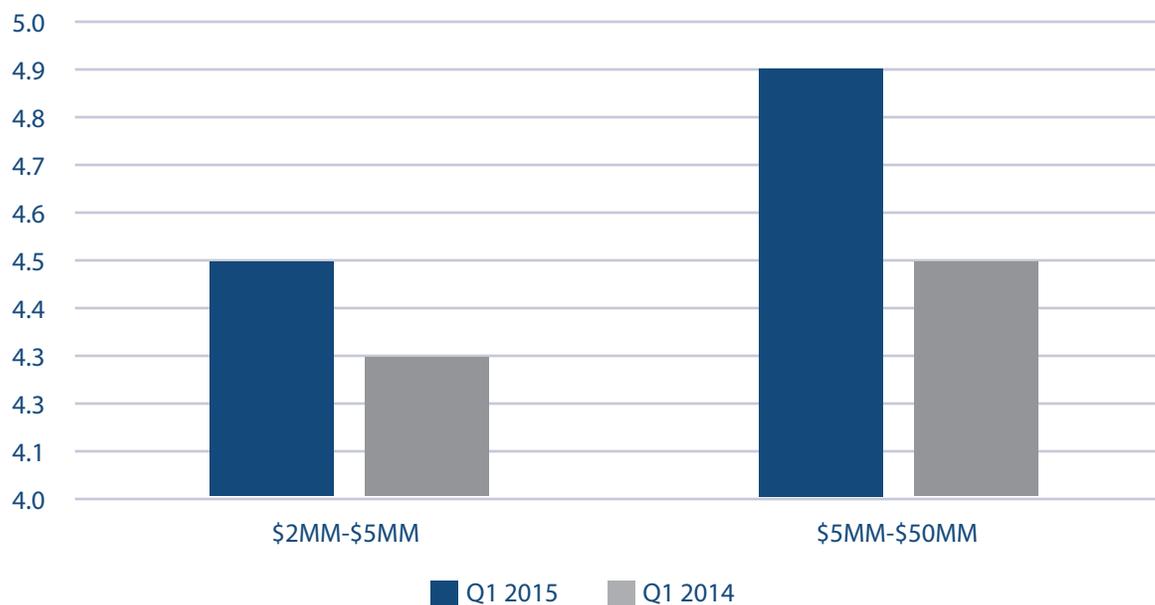
Figure 5: Median Months to Close



**DEAL MULTIPLES**

In the lower middle market, deal multiples grew in both sectors, jumping 0.2 for businesses valued between \$2MM-\$5MM and 0.4 points for businesses valued between \$5MM-\$50MM year over year.

Figure 6: Median EBITDA Multiple Paid



## SELLER FINANCING

Seller financing decreased in Q1 2015, however this survey shows earn outs increasing significantly (particularly in the \$5MM-\$50MM sector), as a tool buyers and seller use to close valuation gaps on growth oriented companies.

Figure 7: Percent of Total Deal Value in Seller Financing and Earn Out

|              | Seller Financing |         | Earn Out |         |
|--------------|------------------|---------|----------|---------|
|              | Q1 2015          | Q1 2014 | Q1 2015  | Q1 2014 |
| \$2MM-\$5MM  | 7%               | 12%     | 4%       | -       |
| \$5MM-\$50MM | 5%               | 15%     | 26%      | 3%      |

## HOT INDUSTRY

Wholesale/distribution, construction, and IT ranked among the leading industries for the lower middle market this sector. Manufacturing and business services also held leading positions.

Figure 8: Top 3 Lower Middle Market Hot Industries

|              |                            |                       |                            |
|--------------|----------------------------|-----------------------|----------------------------|
| \$2MM-\$5MM  | Wholesale/distribution 31% | Manufacturing 19%     | Information Technology 13% |
| \$5MM-\$50MM | Construction 50%           | Business Services 25% | Information Technology 25% |

## BUYER TYPE

Buyers in the lower middle market were most likely to be a private equity group or an existing company/strategic buyer. However, individual buyers were active in the \$2MM-\$5MM sector.

Figure 9: Buyer Type

|              |                         |                      |                                   |
|--------------|-------------------------|----------------------|-----------------------------------|
| \$2MM-\$5MM  | Experienced Owner 37.5% | Existing Company 25% | PE Platform 12.5 & 1st Time 12.5% |
| \$5MM-\$50MM | PE Add-On 50%           | Existing Company 25% | Other 25%                         |

And again this quarter, as in past surveys, the larger the deal the larger the geographic pool of buyers. In the \$5MM-\$50MM sector, the majority of buyers came from over 100 miles away.

*“If your company is doing more than \$10 million in sales, the hurdle of being a car ride or a plane ride away becomes much less of a factor than the industry you’re in and the strategic fit with potential buyers,” said Joe Lindsey, CBI, M&A Source. “Most private equity groups and private companies will search the entire country for the acquisition that will bring them the most value, especially as technology is bringing us all closer.”*

## TERMINATIONS & MISTAKES

Advisors were asked to indicate the top mistakes sellers make that hurt their chances of a sale. The top three mistakes were:

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## **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.

# 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*.

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