

Q4 2015



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

MARKET PULSE

QUARTERLY SURVEY REPORT

FOURTH QUARTER 2015



THE IBBA AND M&A SOURCE MARKET PULSE SURVEY REPORT Q4 2015

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 Q4 2015 survey was completed by 348 business brokers and M&A advisors, representing 38 states. Half of the respondents (56%) had at least 10 years of experience in the M&A industry. Respondents completed 410 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 or (888) 686-4222.

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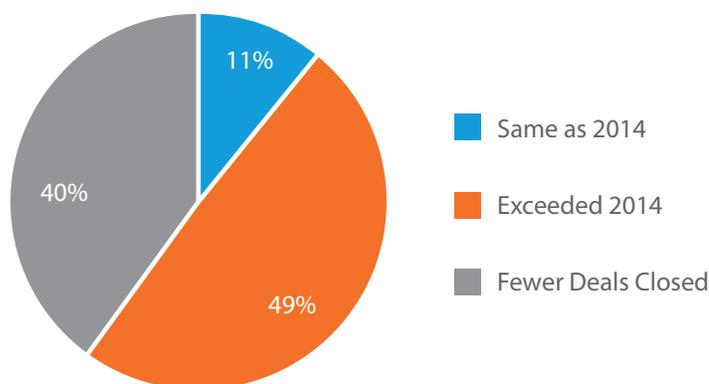
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In 2016, global M&A activity hit a new high at \$5.03 trillion. Of that, \$2.5 trillion was exchanged in the U.S. alone, up over 56% from the previous record set in 2007.¹ These numbers are driven by mega corporate deals (including ten \$50+ billion deals worldwide), lower middle and main street markets are seeing significant increase in deal activity.

According to our survey, business sales remained strong in the Main Street and lower middle market in 2015. More than 60% of advisors met or exceeded their 2014 closure records.

Figure 2: Deals Closed 2015 vs. 2014



Outlooks are positive and M&A advisors are expecting a 60% net increase in new deals in 2016. Compared to a year ago, optimism has grown, with advisors anticipating:

- Greater deal flow
- Increase business exit opportunities for sellers
- Opportunities for growth and general business conditions

“Advisors are still optimistic that general business conditions will be solid again this year,” said Joe Lindsey, CBI, M&AMI, President of JLC, Inc. and M&A Source Chair. “Nineteen percent indicated some pessimism that conditions will deteriorate, which may be attributed to the upcoming election, a continued slump in oil prices, or the early 2016 drop in the stock market.”

Meanwhile, deal multiples remain strong, but advisors aren’t optimistic that multiples will climb any higher in 2016. Notably, advisors also suggest market conditions will remain relatively neutral when it comes to debt financing. However, they report some difficulty arranging financing for companies with revenues of \$500,000 or less.

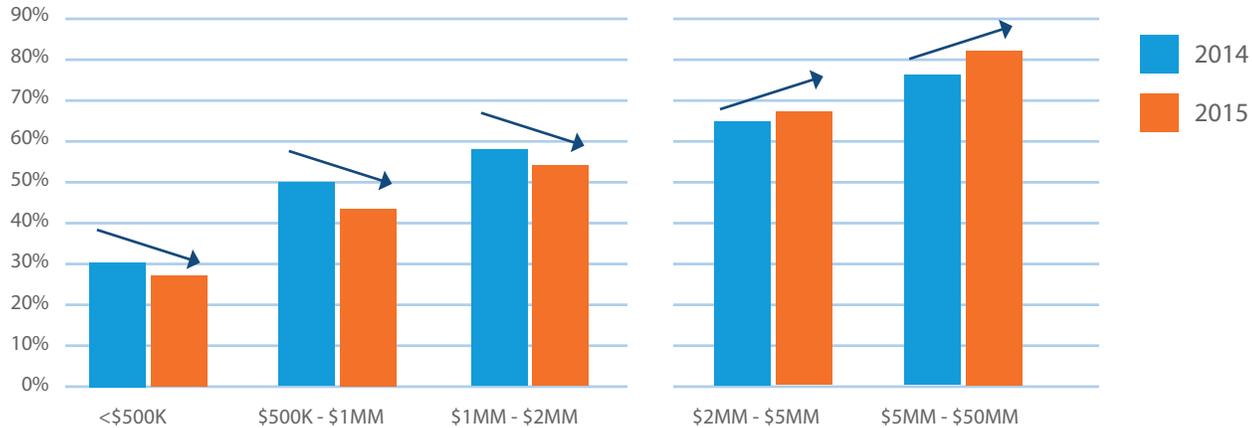
The Small Business Administration had a record year, distributing more than \$23.6 billion in FY2015, with more than 63,000 loans. But according to our study, only 29% of respondents’ deals under \$2 million in value utilized SBA for financing, demonstrating just how incredibly active the Main Street market was in 2015.

1. Deallogic press release Dec. 28, 2015

BUYER VS. SELLER MARKET

Year over year, buyers are increasing their advantage in the Main Street market, particularly for the smallest businesses. Meanwhile, the seller's market sentiment has improved, year over year, in the lower middle market.

Figure 3: Seller's Market Sentiment Trending Down in Main Street, Up in LMM

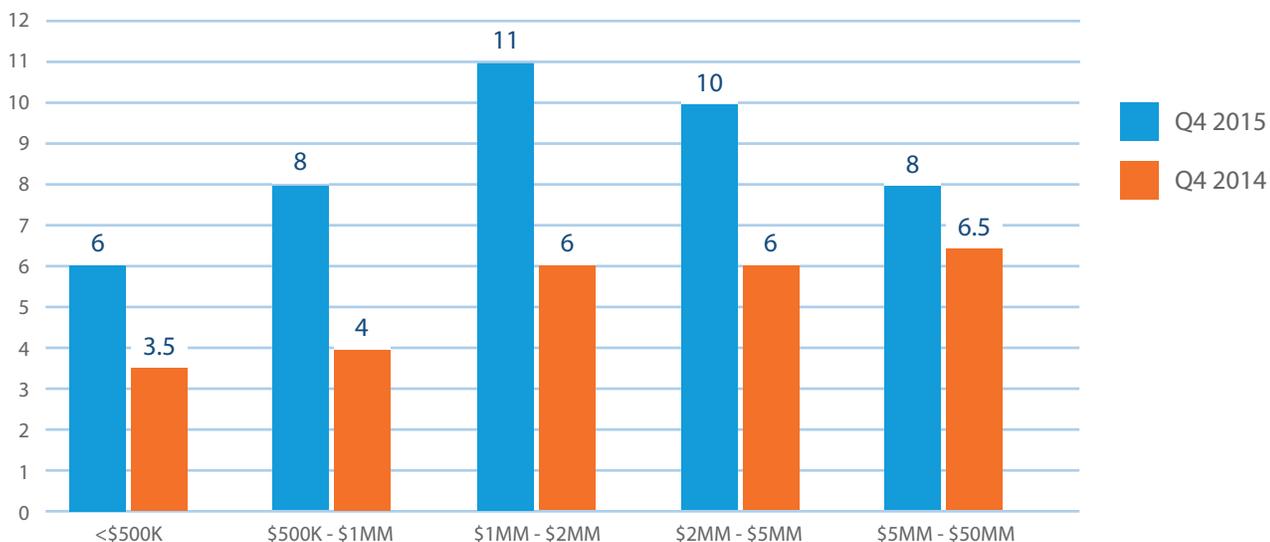


HOW LONG DOES IT TAKE TO COMPLETE A DEAL?

Deals took longer to close across all sectors. Closing times nearly doubled in the Main Street market, while the lower middle market also saw jumps of up to four months.

“Typically the larger the deal, the longer it takes to close,” says Craig Everett, PhD, Pepperdine Private Capital Markets Project, Director. “But the lower middle market has a large number of active buyers, and one way buyers win deals is to show they can close more quickly. As more buyers come to the table, advisors are able to run a more efficient process.”

Figure 4. Median Time to Close Significantly Higher in 2015



New this survey, advisors reported on the average time for deals to move from Letter of Intent (LOI) or Offer to closing. In every sector except the smallest, deals took three months to close after a signed LOI.

“Many sellers believe that once they get a signed LOI their business is ‘sold.’ But quite a bit of legal and due diligence work still needs to be done,” explains David Ryan, President of Upton Financial Group. “It’s important for sellers to understand this is a process, not an event. Moreover, even after you’ve reached the closing table, many sellers need to stay on for a post-sale transition period of anywhere from three months to three years.”

“The clear takeaway here is to make sure you sell before you’re burned out,” says Lisa Riley, CBI, President of LINK Business-Phoenix. “Burnout is the second leading reason sellers put their business on the market, and unfortunately it often leads to lower business performance and lower sale prices.”

VALUATION MULTIPLES

Valuation multiples haven’t seen much change over the last six quarters. Multiples remain strong, at or near market peaks.

Figure 5: Median Multiple Remain Stable

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

Figure 6: Common Multiple Range

Common Multiple Range (SDE)	
<\$500K	57% between 1.5-2.5
\$500K - \$1MM	70% between 2.0-3.0
\$1MM - \$2MM	61% between 2.75-4.0
Common Multiple Range (EBITDA)	
\$2MM-\$5MM	54% between 3.0-4.0
\$5MM-\$50MM	49% between 4.25-6.0

Figure 7: 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 incl. Working Capital

Sellers Discretionary Earnings (SDE)

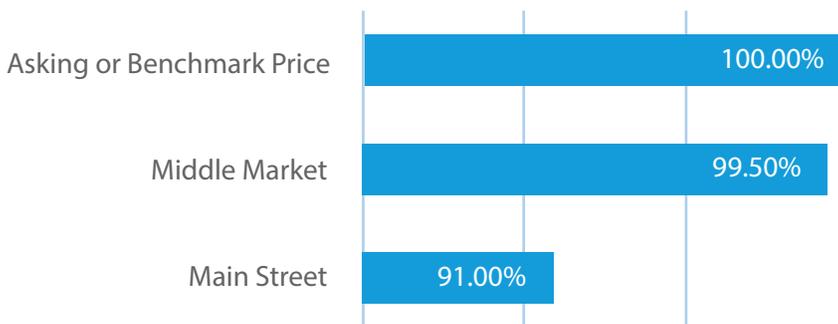
Earnings before Interest Taxes Depreciation Amortization (EBITDA)

For Main Street deals, the common multiple is based on SDE without working capital. Whereas in the lower middle market, EBITDA including working capital is the most common multiple type.

“Sometimes sellers hear someone in their industry got a certain multiple, and they want the same number,” says Scott Bushkie, CBI, M&AMI, President of Cornerstone Business Services and IBBA Chair. “But SDE without working capital is a significantly different value from EBITDA with working capital. So you need to understand the numbers behind the multiple. For instance, a business owner could tell his buddies he sold for an eight multiple, but if that’s really a multiple of net income, he’s probably closer to a three multiple of EBITDA with working capital—which would be under market today.”

Main Street businesses sold for approximately 91% of their asking price in Q4 2015. By comparison, lower middle market businesses—which typically aren’t marketed with an asking price—received 99.5% of the internal benchmark set by the advisor and seller.

Figure 8: Final Price Realized vs. Asking Price

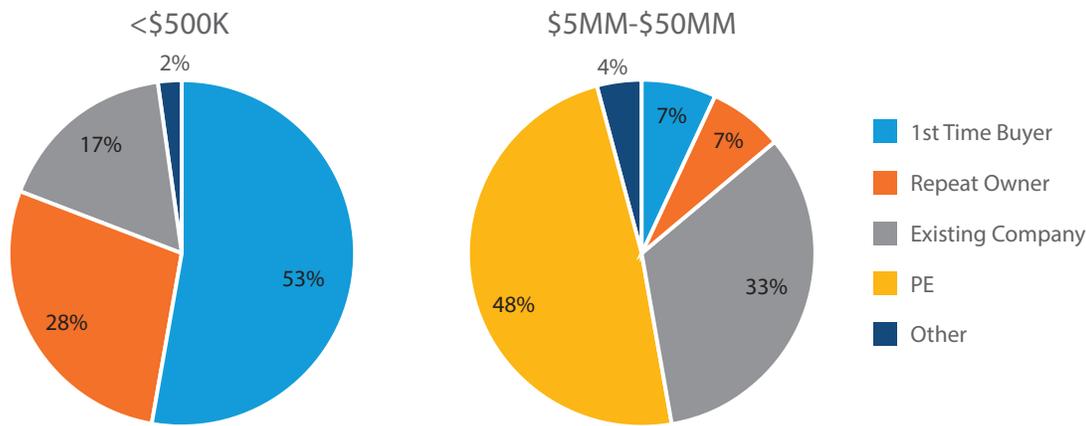


“It’s a great time to sell because of the strong market. And these results go to show that if a business is priced correctly, it’s getting sold,” explained Michael Camerota, M&AMI, CBI Touchstone Advisors. “What we don’t know is how many businesses haven’t sold because they were listed over a realistic benchmark. If you work with the right business broker, they will have the tools and resources to price your business correctly.”

KNOW YOUR BUYER

Size matters in deal multiples and buyer types. 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. PE groups were not active at all in the <\$500K segment, while individual buyers accounted for only 14% (7% first time buyers, 7% repeat owners) of the larger sector.

Figure 9: Buyer Comparison by Smallest/Largest Market Sectors



WHAT MOTIVATES THEM?

Buyers in the Main Street market are most often motivated by a desire to buy a job. That is, the seller 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. Q4 saw an increase in “growth through acquisition” motivated purchases across almost every market sector.

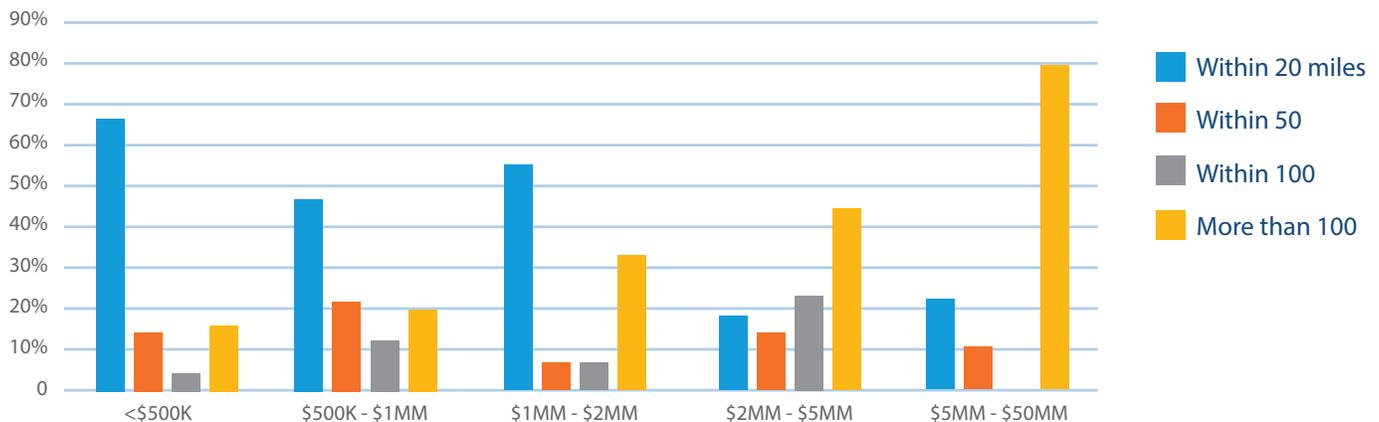
Figure 10: Buyer Motivation Shifts with Transaction Size

Transaction Size	Buying a Job	Growing an Existing Business
<\$500K	51%	30%
\$500K - \$1MM	38%	45%
\$1MM - \$2MM	10%	63%
\$2MM - \$5MM	19%	48%
\$5MM - \$50MM	11%	52%

WHERE DO THEY COME FROM?

As deal size increases, buyers are sourced from a wider geographic area.

Figure 11: Buyer Location (in miles - relative to seller)



HOT INDUSTRIES

Service companies (business and personal) continue to lead Main Street market activity in Q4, with a strong showing in the lower middle market as well. Manufacturing companies led the lower middle market.

Figure 12: Top Three Industries by Size of Transaction

	1	2	3
<\$500K	Restaurants	Personal Services	Business Services
\$500K - \$1MM	Business Services	Manufacturing	Healthcare-Biotech
\$1MM - \$2MM	Business Services	Consumer Goods / Healthcare - Biotech (tied)	
\$2MM - \$5MM	Manufacturing	Business Services	Wholesale Distribution
\$5MM - \$50MM	Manufacturing	Business Services / Construction (tied)	

“For restaurant, business services, or manufacturing business owners who are sitting on the fence in this record market, you have the opportunity for a double win right now—a hot industry in a strong market,” says Russ Pogue of Russell Pogue.

SPECIAL BROKER ADDENDUM

In Q4 2015, most advisors report that their best client arrived by referral, followed by targeted mailers at a distant second. As for referral sources, almost half (43%) came from past clients, followed by accountants and attorneys.

Figure 13: Best Client Source

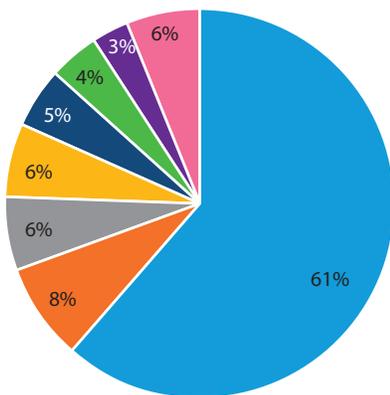
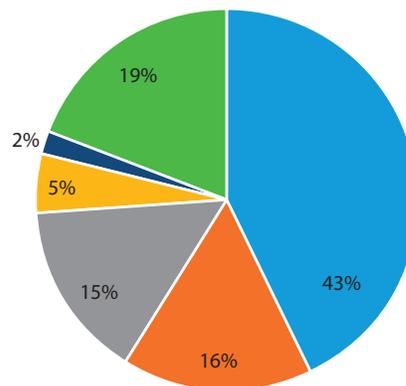


Figure 14: Referral Sources



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 eight 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, 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 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
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