

Q4 2016



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

MARKETPULSE

QUARTERLY SURVEY REPORT

FOURTH QUARTER 2016

THE IBBA AND M&A SOURCE MARKET PULSE SURVEY REPORT Q4 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 Graziadio School of Business and Management.

The Q4 2016 survey was completed by 350 business brokers and M&A advisors, representing 39 states. Half of the respondents (52%) had at least 10 years of industry experience. Respondents completed 308 transactions this quarter.

Figure 1: Market Segments Studied

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

CONFIDENCE, OPTIMISM SOARS FOR 2017

With political surprises around the globe, 2016 was a volatile year. The year's total spending of about \$3 trillion was significantly lower than 2015's record \$5.03 trillion, yet 2016 still remained the third-best year of the last decade.¹

According to our survey, business sales remained strong in the Main Street and lower middle market in 2016. More than 50% of advisors met or exceeded their 2015 closure records. Deal multiples remained at or above 2015 and 2014 levels.

¹ Global M&A Down But Not Out After Weathering 2016's Surprises. Bloomberg, Dec. 20, 2016.

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 and director, 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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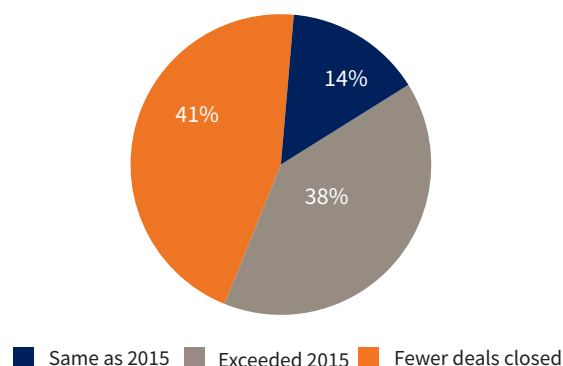
Craig R. Everett
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Figure 2: Advisor Performance 2016



Outlook is positive as 74% of advisors are expecting an increase in new clients coming to market in 2017. Compared to a year ago, optimism has grown, with advisors anticipating:

- Greater deal flow
- Better closing rates
- Increased business exit opportunities for sellers
- Opportunities for growth
- An improvement in general business conditions

Deal multiples remain strong, but advisors aren't optimistic that multiples will climb any higher in 2017. 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 \$100,000 or less.

"Small business optimism is on the rise, following the election. If President Trump can follow through on his commitment to lower taxes and create a more business-friendly climate, we should see increased activity in the market," said Craig Everett, PhD, Director of the Pepperdine Private Capital Markets Project. "If the corporate tax rate drops from 35% to 15%, as Mr. Trump has proposed, businesses will have more capital to push into expansion and acquisition."

"What's more, Mr. Trump wants to offer a special tax repatriation holiday, dropping the rate to 10%. This could bring billions of dollars back to the U.S." continued Everett. "Some of that could be spent in the lower middle market, making strategic buyers a real force to be reckoned with in terms of buying power."

TOP INDUSTRIES IN 2016

Looking at data for the whole year, restaurants, personal services, and consumer goods led the Main Street market in 2016. In the lower middle market, manufacturing was the standout leader at 30% of all reported transactions, followed by construction and wholesale/distribution.

Figure 3: 2016 Hot Industries - Main Street

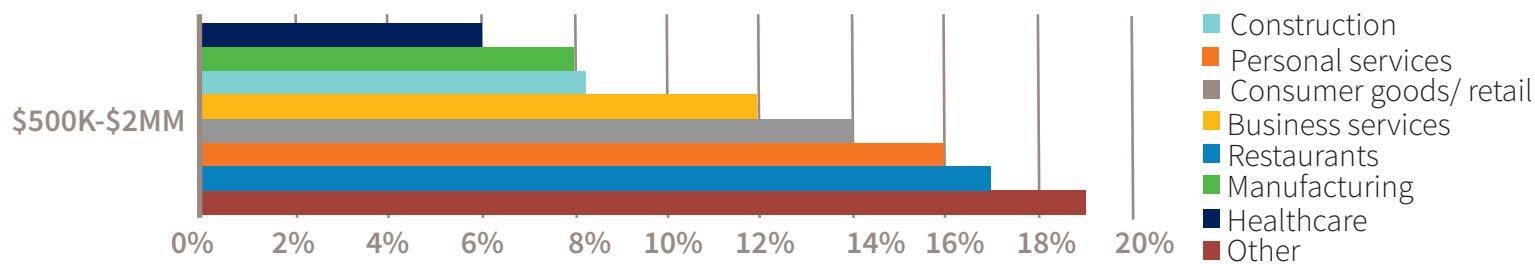
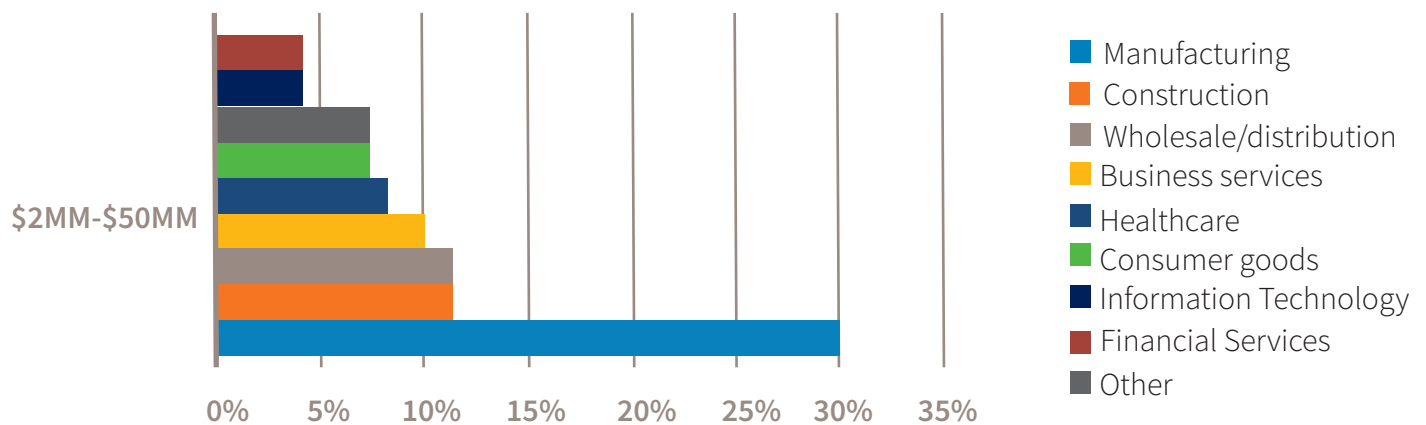


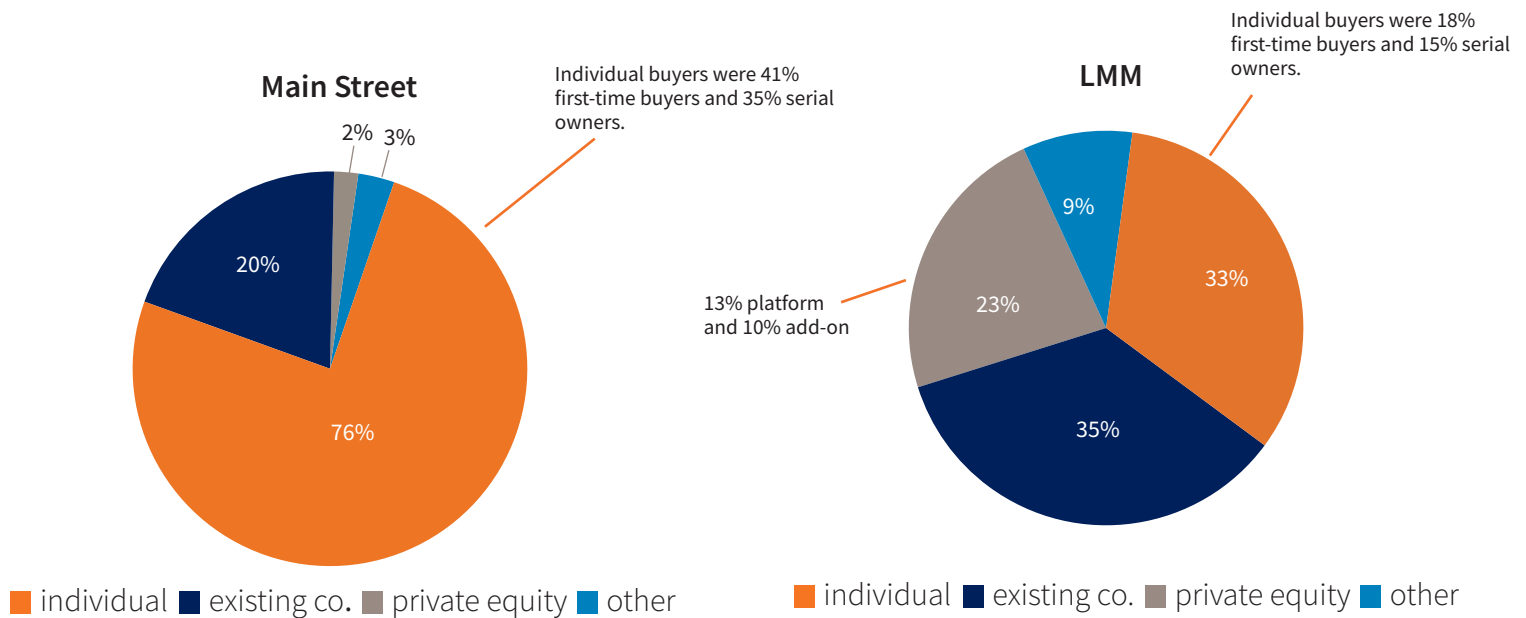
Figure 4: 2016 Hot Industries - Lower Middle Market



ACTIVE BUYERS IN 2016

The Main Street market was dominated by individual buyers in 2016, with only 20% of acquisitions made by existing companies and minimal private equity activity. In the lower middle market, however, individual buyers competed alongside existing companies and private equity for their sale of the deals.

Figure 5: 2016 Active Buyers



WHY ARE OWNERS SELLING?

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

Figure 6: Top 2 Reasons Sellers Went to Market

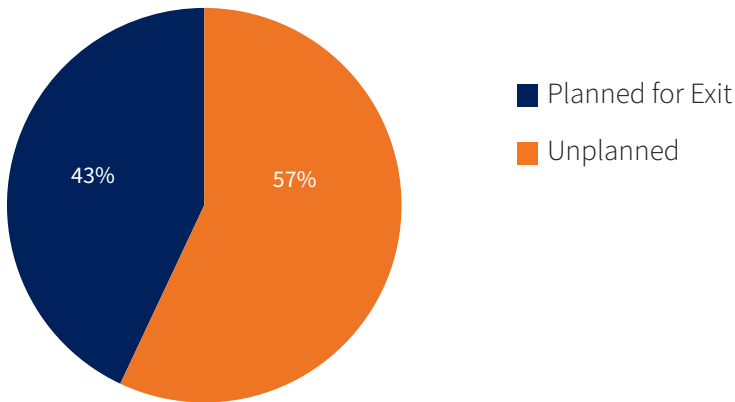
Deal Size	#1 Reason	#2 Reason
<\$500K	Retirement	Burnout
\$500K - \$1MM	Retirement	Burnout
\$1MM - \$2MM	Retirement	(TIE) Burnout/Opportunity
\$2MM - \$5MM	Retirement	New Opportunity
\$5MM - \$50MM	Retirement	Burnout

“It’s interesting to see that while retirement remains steady as the number one reason sellers go to market, fewer than half of sellers planned ahead for their transition,” said Lisa Riley, CBI, Principal of LINK Business-Phoenix. “We already know that burnout is a leading reason sellers go to market, but now we can see that several retirement sales may be triggered by some kind of event or impulse. That’s unfortunate, because people who plan ahead for their retirement typically get a much higher value than sellers who transition in a period of high emotion, pressure, or burnout.”

“We may already be seeing some of that small business optimism come into play as new opportunities push some business owners to market,” said Lou Vescio, CBI, M&AMI, Principal, Coastal Business Intermediaries, Inc., IBBA Chair. “As the economy continues to do well and confidence grows, people will continue to see fresh opportunities. These sellers may be starting or acquiring new businesses, or they may be rejoining the professional workforce, lured away to executive leadership roles as other Boomers retire.”

New this survey, advisors were asked how many of their clients had planned for a business sale. Responses showed that less than half (43%) had an intentional, proactive exit strategy.

Figure 7: Less Than Half of Sellers Planned for Exit

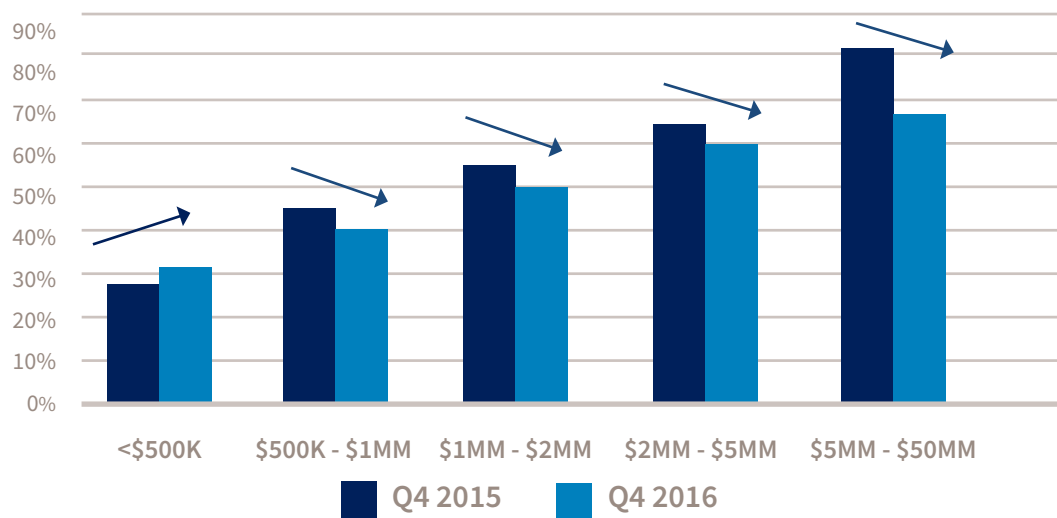


“Again, think if you were in the corporate world for 40 years and waited until 2 months before retirement to set up your 401(k) and only then started thinking about how you will effectively fund your retirement. You would say that is crazy—yet the majority of business owners do just that and statistics show that owners typically will rely on the proceeds from the sale to fund 60-100% of their retirement to live the lifestyle they want for the rest of their lives. Scary...” said Scott Bushkie, CBI, M&AM, President of Cornerstone Business Services, Inc.

WHO HAD THE ADVANTAGE: BUYERS OR SELLERS?

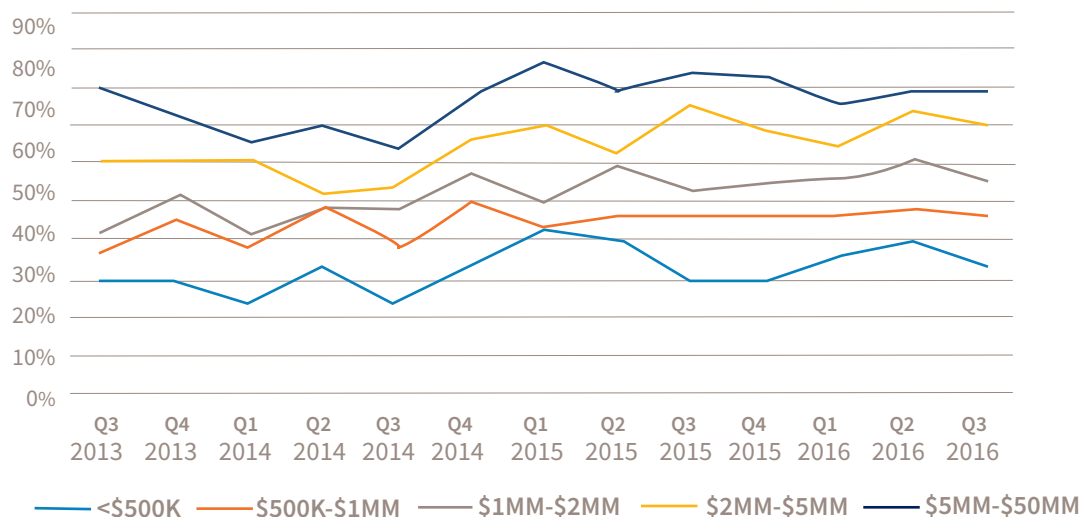
For the first time, four of the five market sectors showed a reduction in seller-market sentiment. However, sellers still maintained the advantage in any deal over \$1 million in value. The decline may be attributed to strong optimism for increased deal flow in 2017, with 74% of advisors predicting that deal flow will increase (and 20% predicting significant increases). As market supply increases, sellers lose some advantage compared to those who get in ahead of the curve.

Figure 8: Seller-Market Sentiment Declining



“Advisors completed the Market Pulse survey during the first two weeks of the year, a time when they’re typically responding to an influx of calls from potential sellers ready to take action on new year’s resolutions,” said John Howe, M&AM, Director, Business Transition Strategies, M&A Source Chair. “This year, we’re hearing a lot of buzz about an uptick in calls and higher than usual inquiries from our network and colleagues. That increase in expected deal flow could be driving down ongoing seller leverage.”

Figure 9: Sellers Market, Historical Trends



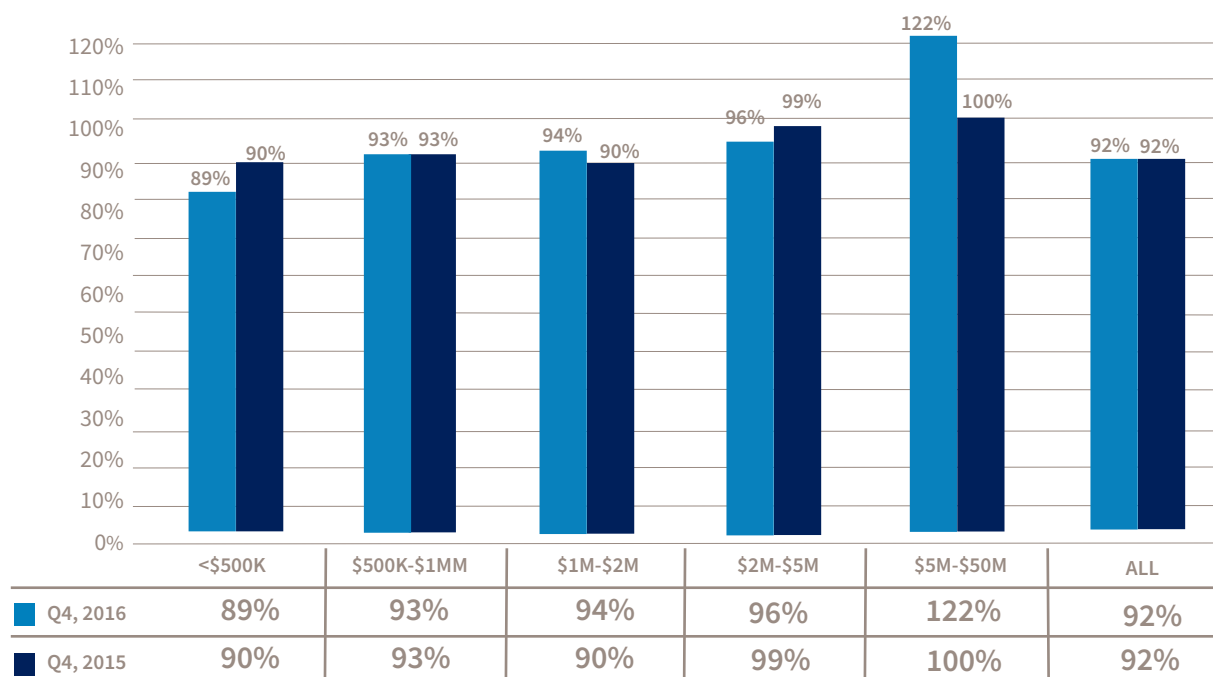
“A lot of it is simple Economics 101—Law of Supply and Demand. Currently there are many more well-funded buyers than quality sellers on the market so the seller has the advantage. As more sellers come on the market, some of that leverage will be lost as the buyers will have more options,” said Diana Miles, CBI, Co-Founder of Bridge Mergers and Acquisitions.

“If Trump tax cuts do come to fruition, that could be enough to nudge even more business owners into selling and transitioning away from their businesses,” Miles continued.

WHERE ARE BUSINESS VALUES TRENDING?

Year-over-year, final sale prices remain fairly consistent as a percentage of the pre-set asking price or internal benchmark. However, advisors reported a premium for deals valued at \$5 million and above. There appeared to be about a 20% premium in the fourth quarter, over deals of a similar size last year.

Figure 10: Final Price Realized Versus Asking Price



Multiples continue to remain strong in all categories, demonstrating a relative plateau in the Main Street market. Year-over-year, multiples saw the biggest gains in the lower middle market.

Figure 11: Median Multiple Increases for Businesses

	2016				2015				2014	
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Median Multiple Paid (SDE*)										
<\$500K	2.3	2.3	2.3	2	2	2	2	2	2	2
\$500K - \$1MM	2.8	3.0	2.8	2.8	2.8	2.5	2.5	2.7	2.9	2.5
\$1MM - \$2MM	3.3	3.3	3.3	3.0	3.3	2.8	3	3.3	3	3.3
Median Multiple Paid (EBITDA*)										
\$2MM - \$5MM	4.8	4.5	4.0	4.0	4	4	4	4.5	4.6	4
\$5MM - \$50MM	5.5	5.8	5.1	5.5	5.1	5.3	5	4.9	5	5.1

Figure 12: Common Multiple Range Q4

Common Multiple Range (SDE)	
<\$500K	72% between 1.75 - 2.75
\$500K - \$1MM	71% between 2.25 - 3.25
\$1MM - \$2MM	66% between 2.75 - 3.75
\$2MM - \$5MM	80% between 3.25 - 4.25
Common Multiple Range (EBITDA)	
\$2MM - \$5MM	44% between 4.25 - 4.75
\$5MM - \$50MM	54% between 5.25 - 7.75

“Global M&A market volume was down in 2016, but that didn’t hurt multiples in the Main Street or lower middle markets. For the most part, we’re seeing multiples at or above the fourth quarter levels since 2014,” said John Paglia, Executive Director, Peate Institute for Entrepreneurship. “Looking at the common multiple ranges, we see a fairly sizable spread in the lower middle market, with outliers above and below. As always, that may tie back, in part, to seller preparation. Those who prepare and plan ahead typically get the higher side of deal multiples.”

Figure 13: 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	SDE incl. working capital
\$5MM - \$50MM	EBITDA incl. working capital

*SDE Sellers Discretionary Earning

*EBITDA Earnings Before Interest, Taxes, Depreciation and Amortization

“Working capital issues can be confusing for sellers. This is a key area where do-it-yourselfers and novice brokers often trip up,” stated David Ryan, an advisor with Upton Financial Group in California.

“If you get the multiple right, but include working capital, you may leave money on the table. On the flip side, you could end up pricing your business out of the market,” Ryan continued. “Working capital calculations and whether they are included in the sale price or ‘in addition to’ are some of those key differentiators that mark out an experienced M&A team.”

The average time to close is 8.3 months, which is about average or a little faster than the norm. Meanwhile, sellers continue to get the majority cash at close. In this quarter, owners got 77% or more cash at close with the majority of the balance being seller financing, along with some earn-outs to close the valuation gap.

Figure 14: Largest Businesses Taking Longer to Sell in Q4 2016

	Q4 2016		Q4 2015	
Business Value	Months to Close	Months from LOI to Close	Months to Close	Months from LOI to Close
<\$500K	7	2	6	2
\$500K - \$1MM	7	3	8	3
\$1MM - \$2MM	8.5	3	11	3
\$2MM - \$5MM	9	3	10	3
\$5MM - \$50MM	10	4	8	3

Figure 15: Portion of Sale Received as Cash at Close

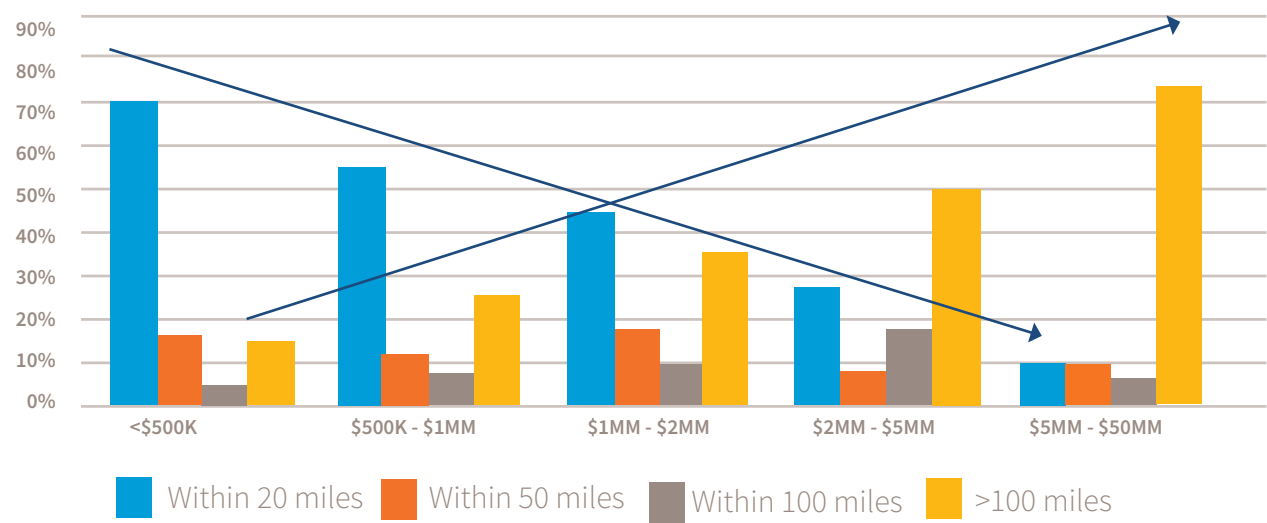
	Cash at Close*	Seller Financing	Earn-Out	Retained Equity	Other
<\$500K	85%	11%	1%		3%
\$500K - \$1MM	83%	13%	1%		2%
\$1MM - \$2MM	87%	11%	1%		1%
\$2MM - \$5MM	77%	19%	4%		
\$5MM - \$50MM	83%	4%	1%	3%	8%

* Cash at close reflects a combination of buyer's equity and senior debt.

WHERE DO BUYERS COME FROM?

Survey results show a direct correlation between the size of the company and buyer proximity. Typically, buyers are sourced from a wider geographic area as deal size increases. As the business size increases, the likelihood of working with a local buyer is significantly reduced.

Figure 16: Buyer Locations (in miles- relative to seller)



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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.

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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. For more information about IBBA, visit the website at www.ibba.org or follow the IBBA on [Facebook](#), [Twitter](#), and [LinkedIn](#).

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