

Q4 2019



MARKETPULSE

INTERNATIONAL BUSINESS BROKERS ASSOCIATION | M&A SOURCE | FOURTH QUARTER 2019 SURVEY





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.

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The IBBA and M&A Source Market Pulse

SURVEY REPORT Q4 2019

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 Business School.

The Q4 2019 survey was conducted January 1-15, 2020 and completed by 300 business brokers and M&A advisors. Respondents completed 273 transactions this quarter.

FIGURE 1: MARKET SEGMENTS STUDIED

| MAIN STREET | LOWER MIDDLE MARKET |
|------------------|---------------------|
| Less than \$500K | \$2MM - \$5MM |
| \$500K - \$1MM | \$5MM - \$50MM |
| \$1MM - \$2MM | |

Market Outlook Positive for 2020

Valuations for small and medium businesses held strong in 2019, remaining at or above market peaks. In the past year, median multiples never varied more than 0.2 points in any market sector, and Q4 2019 ended on par with the year prior.

Generally, business brokers and M&A advisors expect more of the same in 2020. While they do expect deal flow and successful closings to grow, advisors predict a negligible uptick in multiples this year. Specifically, 55% of advisors predict the volume of deals (under \$50 million) will increase in the next 12 months, but only 7% expect an increase in multiples.

Optimism is positive for the year ahead, with advisors anticipating:

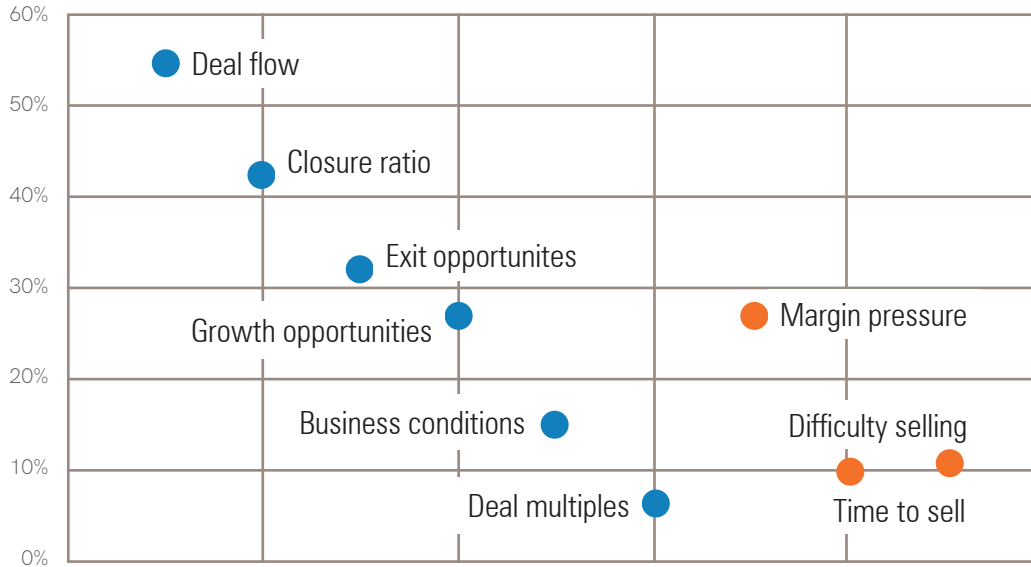
- Greater deal flow
- Increased business exit opportunities for sellers
- Opportunities for business growth
- Better closing rates
- Improved general business conditions

Meanwhile, advisors expect that businesses will take longer to sell in 2020 and that closing deals will become more difficult. Business brokers representing small businesses valued at less than \$500,000 point to financing challenges as an obstacle to getting deals done.

FIGURE 2: MULTIPLES AT OR NEAR PEAK

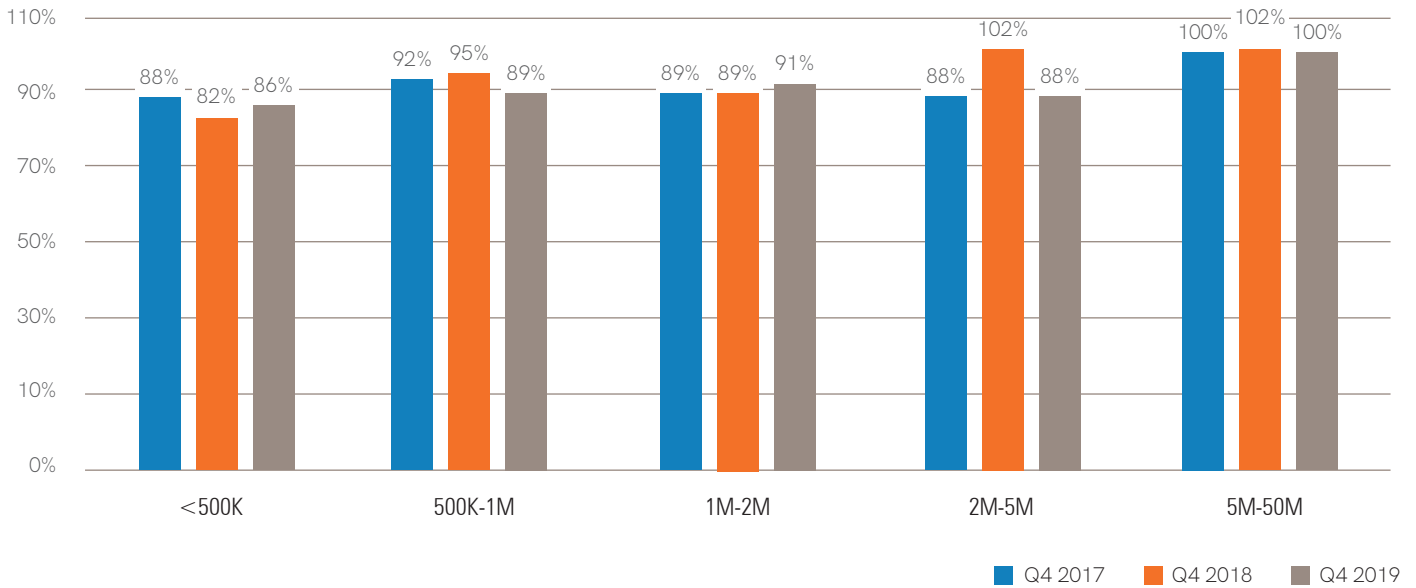
| | 2019 Q4 | 2018 Q4 | 2017 Q4 | 2016 Q4 | 2015 Q4 | 2014 Q4 |
|-------------------------------|---------|---------|---------|---------|---------|---------|
| Median Multiple Paid (SDE) | | | | | | |
| <\$500K | 2.0 | 2.0 | 2.0 | 2.3 | 2.0 | 2.0 |
| \$500K - \$1MM | 2.8 | 2.8 | 2.5 | 2.8 | 2.5 | 2.9 |
| \$1MM - \$2MM | 3.3 | 3.3 | 3.1 | 3.3 | 3.3 | 3.0 |
| Median Multiple Paid (EBITDA) | | | | | | |
| \$2MM - \$5MM | 4.3 | 4.3 | 4.3 | 4.8 | 4.0 | 4.6 |
| \$5MM - \$50MM | 5.8 | 5.8 | 5.5 | 5.5 | 5.1 | 5.0 |

FIGURE 3: ADVISOR CONFIDENCE SCORE FOR INDUSTRY INDICATORS



55% of advisors predict the volume of deals (under \$50 million) will increase in the next 12 months, but only 7% expect an increase in multiples.

FIGURE 4: FINAL SALE PRICE VS. ASKING PRICE/INTERNAL BENCHMARK



8.6 months

Average time to sell a small business

Time to Close

The average time to sell a small business has risen to 8.6 months, up from 6.4 months in 2013. Of that, roughly 60 to 120 days are spent in due diligence and execution, after a signed letter of intent.

FIGURE 5: TIME TO CLOSE UP 34% IN LAST SIX YEARS

| | Months to close | | | Months LOI to close |
|---------|-----------------|---------|------------|---------------------|
| | Q4 2013 | Q4 2019 | % increase | Q4 2019 |
| <500K | 3 | 7 | 133% | 2 |
| 500k-1M | 5 | 7 | 40% | 3 |
| 1M-2M | 6 | 9 | 50% | 3 |
| 2M-5M | 8 | 9 | 13% | 3 |
| 5M-50M | 10 | 11 | 10% | 4 |
| avg. | 6.4 | 8.6 | 34% | |

“Small businesses valued at less than \$500,000 have become harder to sell in the last few years. Advisors have consistently singled out that sector as a buyer’s market, with more supply than buyer demand. Financing is also an issue as individual buyers struggle to line up the cash and lending support necessary to complete these deals,” said Barry Berkowitz, principal, Berkowitz Acquisitions.

And while time to close has risen slightly for lower middle market deals, advisors suggest that those timelines have more to do with increased deal flow and due diligence. Businesses valued at \$2 million and above are solidly in a seller’s market, with strong competition for the best opportunities.



“Organic growth has become more difficult right now, due in part to the tight labor market. So, organizations are looking at M&A to drive value. Likewise, private equity and family offices have significant liquidity and is driving a very active M & A marketplace,” said Robert McCormack, managing partner, Murphy McCormack Capital Advisors.

“As valuations rise, due diligence increases,” said Craig Everett, PhD, director of the Pepperdine Private Capital Markets Project at the Pepperdine Graziadio Business School. “Buyers are paying a premium for lower middle market deals, so deal teams are spending more time verifying seller data and validating their investment recommendations.”

Financing Deals In 2019

Advisors indicate that the lending market has been conducive to getting deals done, particularly for businesses with revenue of \$5 million or more. Dealmakers are struggling, however, to help buyers secure financing in the smallest Main Street sector.

Sellers, meanwhile, continue to get the majority cash at close. In this quarter, owners received 79% or more cash at close with most of the balance being seller financing, along with some earnouts and retained equity to close the valuation gap.

FIGURE 6: EASE OF ARRANGING DEBT IN 2019, BY COMPANY REVENUE (-3 TO 3 SCALE)

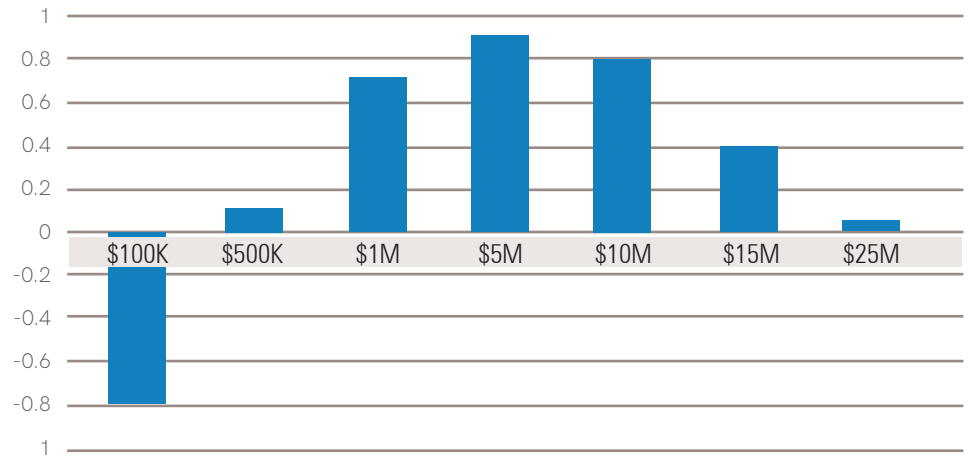
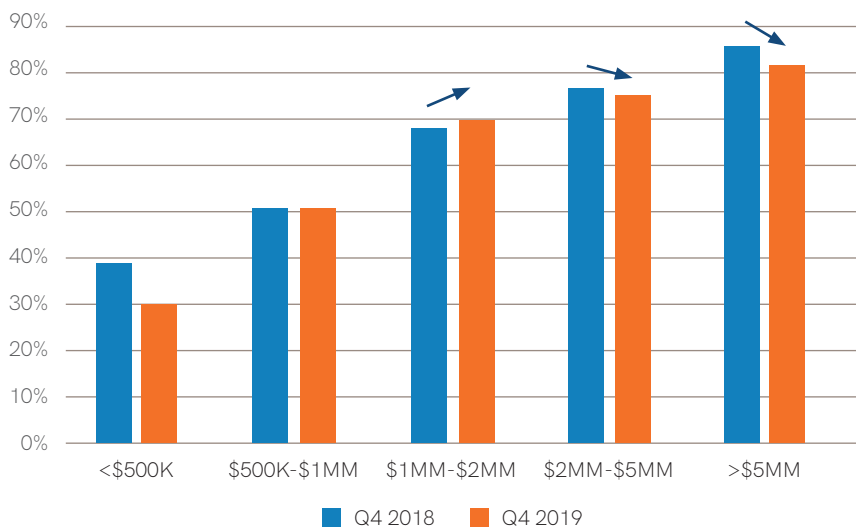


FIGURE 7: PORTION OF SALE RECEIVED AS CASH AT CLOSE

| Revenue Range | Cash at Close* | Seller Financing | Earn Out | Retained Equity |
|---------------|----------------|------------------|----------|-----------------|
| <\$500K | 83% | 13% | 2% | - |
| \$500K-\$1MM | 79% | 14% | 2% | 2% |
| \$1MM-\$2MM | 80% | 14% | 2% | 1% |
| \$2MM-\$5MM | 80% | 15% | 4% | 1% |
| \$5MM-\$50MM | 82% | 11% | 2% | 3% |

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

FIGURE 8: Q4 2019 SLIGHTLY LESS OF A SELLER'S MARKET THAN YEAR AGO, ADVISORS SAY

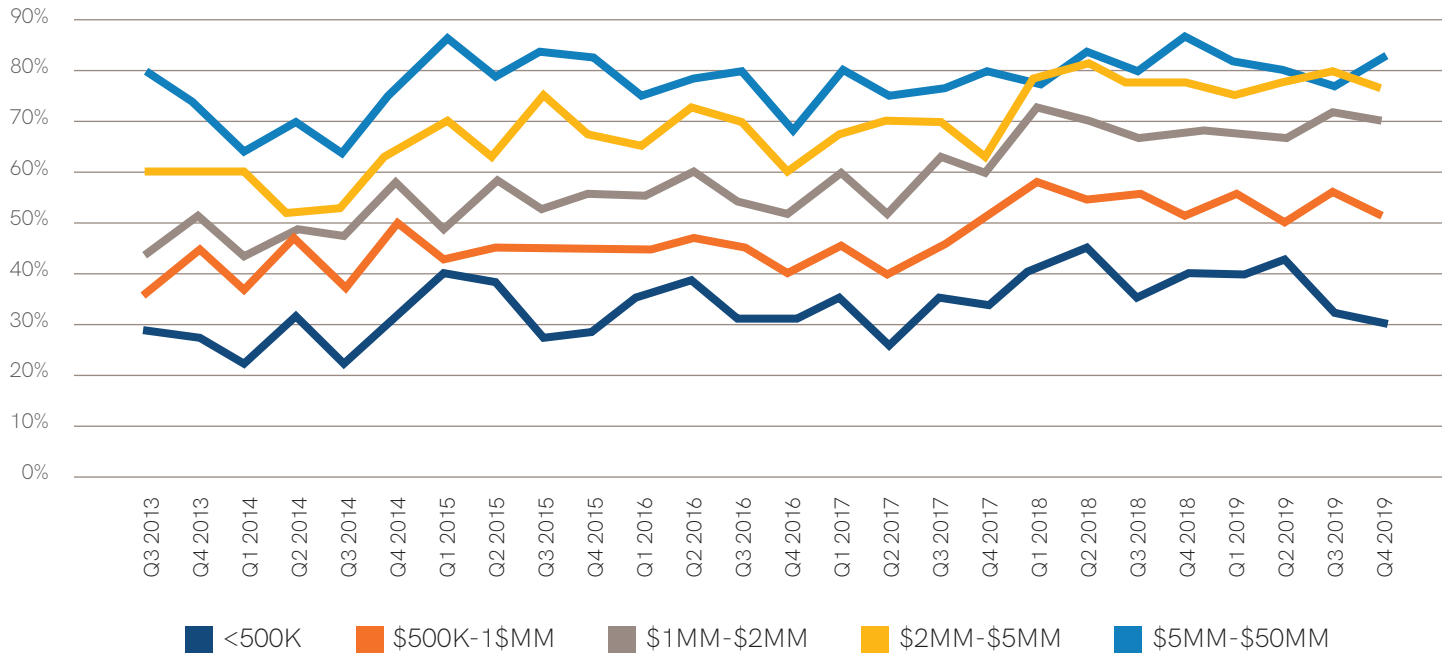


Seller's Market

Seller-market sentiment dipped slightly in the lower middle market this quarter, but advisors still indicate that sellers have a strong advantage across all but the smallest business sector. Excluding businesses valued at less than \$500K, advisors have not rated any sector as a buyer's market since Q3 2017.

Seller sentiment for lower middle market deals remains near record peaks. The downward trend can most likely be attributed to uncertainty due to the upcoming 2020 elections.

FIGURE 9: SELLER MARKET SENTIMENT, HISTORICAL TRENDS



2019 Top Industries

Restaurants and personal services led the Main Street market in 2019, while manufacturing and construction led the lower middle market.

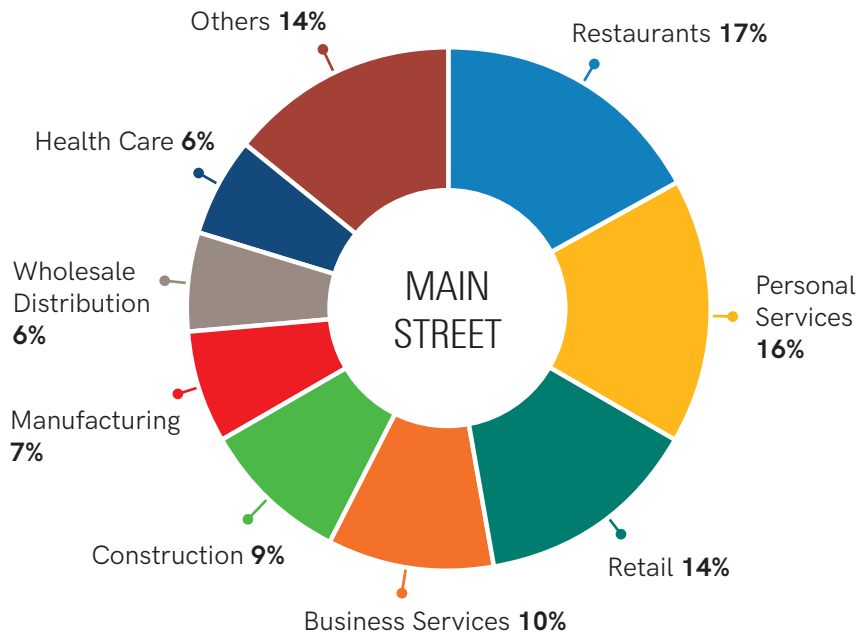
“The reason we call deals under \$2 million, ‘Main Street’ is because they are the kind of businesses you find on the primary commercial streets across America,” said Scott Bushkie, managing partner, Cornerstone Business Services. “The fact that 50% of small business transitions came from restaurants, retail, and personal services comes as no surprise. The good news for business owners is that even though these can be tough businesses to operate, they are sellable, especially in this marketplace.”

In the lower middle market, it’s interesting to see that manufacturing companies are still a sought-after asset class, as they sit at nearly a quarter of business sales. Despite media headlines about the impact of tariffs and trade wars, these companies seem to be doing well and are finding solid interest from buyers.

Construction trades can be a tougher sell because many times the owner is the business, until the company reaches a certain size and infrastructure. Even with that said, 17% of lower middle market deals came from the construction and engineering industries, probably the largest seen in the survey’s history.



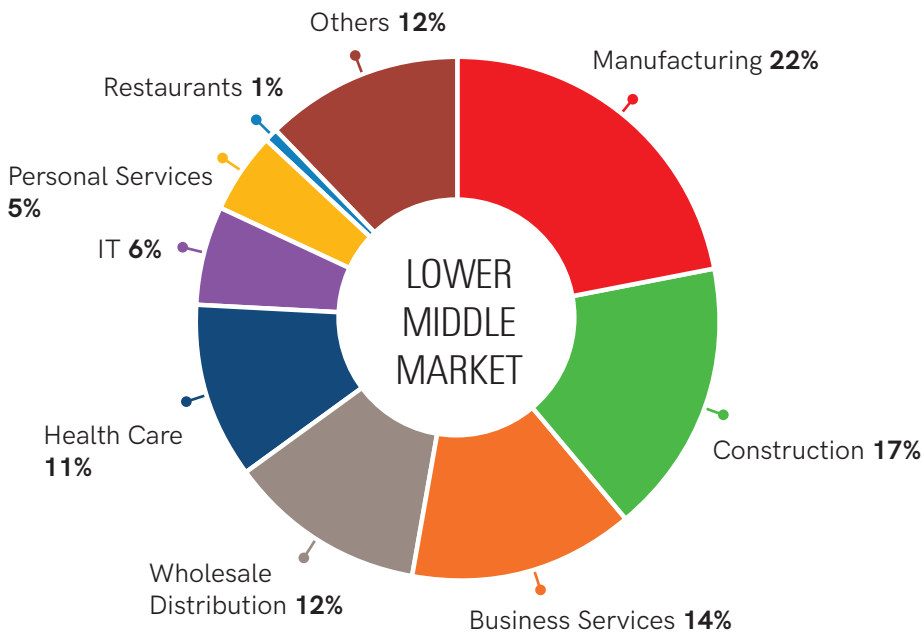
FIGURE 10: 2019 BUSINESS SALES BY INDUSTRY – MAIN STREET



17%

of lower middle market deals came from the construction and engineering industries, probably the largest seen in the survey's history.

FIGURE 11: 2019 BUSINESS SALES BY INDUSTRY – LOWER MIDDLE MARKET



“The number of business transactions in the construction industry tells us something about the strength of the economy and the number of building projects being completed,” said Kyle Griffith, managing partner, The NYBB Group. “People are spending dollars to pick up market share or to get into the industry.”

2019 Active Buyers

First time buyers dominated the Main Street market, followed by serial entrepreneurs and existing companies. In the Main Street market, individuals made up 74% of business buyers (43% first time buyers, 31% serial entrepreneurs).

"It's no surprise that individuals dominated the Main Street buyer market. But it's worth noting that small business sales are still taking place, even in today's tight labor market," said Larry Hughes, owner, The Hughes Group, Inc. "Almost anyone who wants a job can get one. Even so, over 40% of Main Street businesses went to first time buyers. It's the American dream. People want to build something for themselves and control their own destiny."

In the lower middle market, 40% of buyers were existing companies. This makes sense as balance sheets are strong, and the lending environment is still conducive to acquisitions. With the labor market how it is, companies are having trouble finding the talent they need to grow organically, and that is driving businesses to look to acquisition for growth.

Private equity firms remain active, representing 25% of lower middle market buyers in 2019 - same as 2018. Individual buyers (first time and serial) also tracked very closely to last year's trends, coming in at 31% in 2019, just a slight drop from 34% a year ago.

FIGURE 12: 2019 ACTIVE BUYERS – MAIN STREET

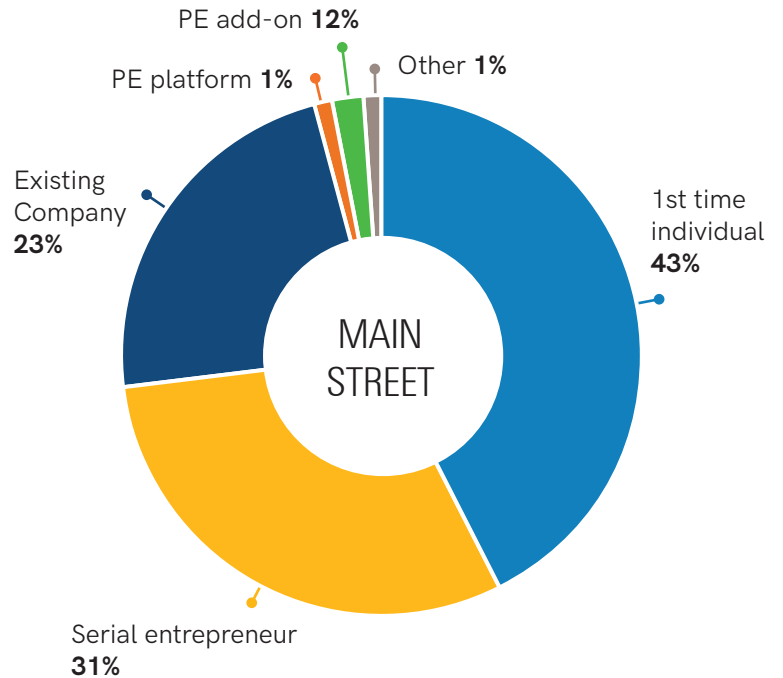
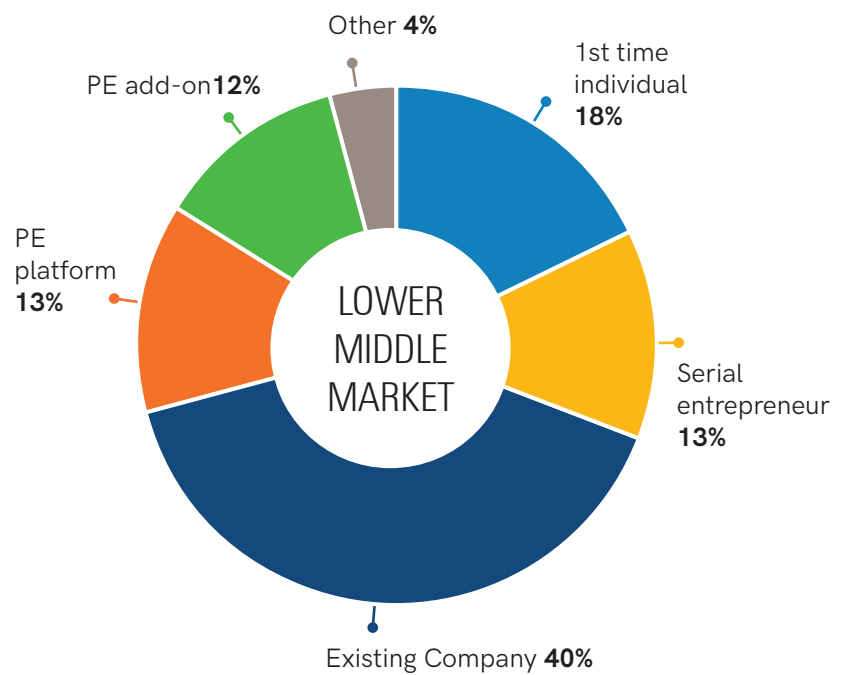


FIGURE 13: 2019 ACTIVE BUYERS – LOWER MIDDLE MARKET



"Even though we continue to hear concerns about a possible recession, private equity activity isn't slowing down," said David Ryan, advisor, Upton Financial Group in California. "That's worth noting because private equity generally needs to demonstrate a return in five to seven years, while existing companies and individual buyers can plan for more of a long-term hold. It seems they still see returns ahead from the M&A market."

Exit Planning

In 2019, nearly half of all small business sellers were planning to retire. “Even with retirement leading as the number one reason for sale, most sellers do not engage in a proactive planning process, particularly in the Main Street market,” said Lisa Riley, principal, Delta Business Advisors. “Generally, the smaller the business, the less likely the owners are to do any planning prior to going to market.”

Of the sellers who plan ahead, most are moving through the exit planning process at a rapid pace, with less than a year between initial consultation and market listing.

FIGURE 14: REASONS SELLERS WENT TO MARKET IN 2019

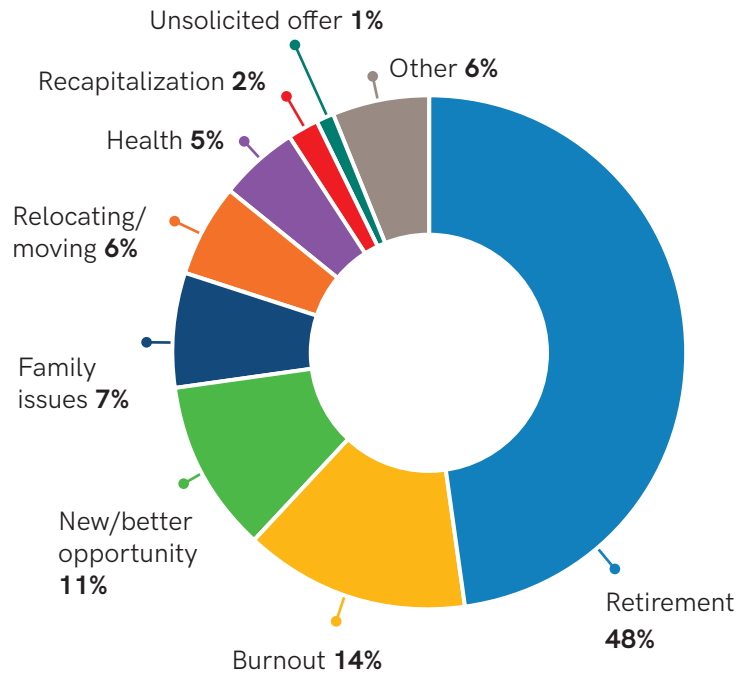
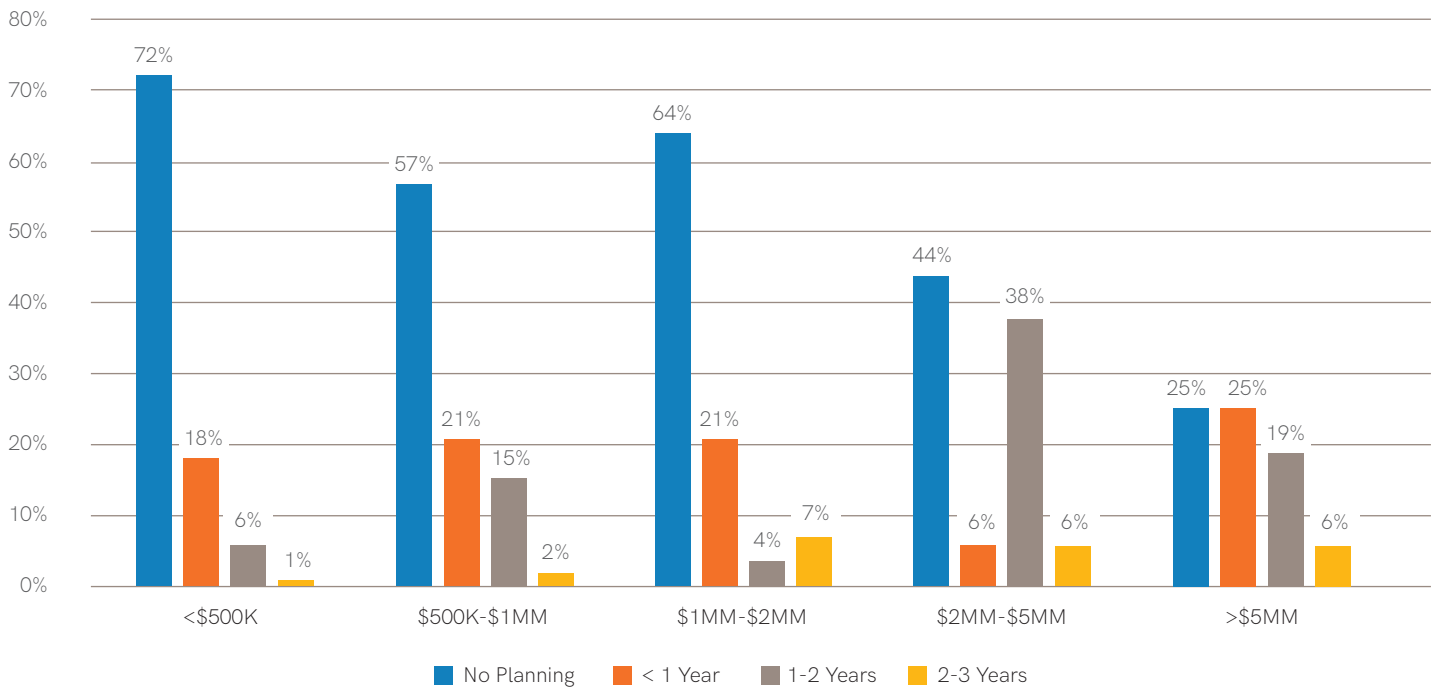


FIGURE 15: PROACTIVE EXIT PLANNING



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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 the 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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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. For more information about the M&A Source visit www.masource.org or follow The M&A Source on [Facebook](#), [LinkedIn](#), or [Twitter](#).



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