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Report hints at waning M&A market

Local deal adviser says it's still a seller's market locally, but the climate may be shifting.

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| By Rachel Watson |

A recent report on U.S. mergers and acquisitions activity shows sellers of companies still hold the advantage, but transaction values appear to have peaked.

The International Business Brokers Association, M&A Source and the Pepperdine Private Capital Market Project at Pepperdine University last month published their Q1 2019 Market Pulse Report, which is based on a survey conducted April 1-15 of 292 U.S. business brokers and M&A advisers who completed 257 transactions in the first quarter.

The 28th edition of the quarterly report studied the "main street" and lower middle market segments, which the publishers define as businesses valued at $0-$2 million and $2 million-$50 million, respectively.

Seller's market sentiment was found to be down in all market segments except for businesses with $5 million to $50 million in enterprise value. In the latter segment, seller's market sentiment increased from 77% in Q1 2018 to 81% in Q1 2019.

"Businesses with enterprise value of $5 million or more are most in demand right now. The market is not cooling at all for those sellers," said Gary Papay, managing partner of Hughesville, Pennsylvania-based M&A advisory firm IBG Business, gpapay@ibgbusiness.com.

Looking back a year, seller's market sentiment decreased for businesses valued between $1 million and $2 million, dropping 6 percentage points from Q1 2018 (72%) to Q1 2019 (66%).

"This is the first time in years that we've seen four out of five sectors report a dip in seller market sentiment," said Craig Everett, director of the Pepperdine Private Capital Markets Project.

"This is a sign the market may have peaked, and more people are expecting a correction in the year or two ahead."

Everett said sellers should sell now before values dip or wait until the market climbs back up.

"To be clear, this doesn't mean you won't be able to sell your business over the next few years, but you probably won't get the multiples you can get today," he said, noting prices are affected by market pessimism or optimism.

Max Friar is managing partner at Calder Capital and co-founder with Matt Baas of Small Business Deal Advisors. Both firms are based in Grand Rapids.

SBDA brokers deals for main street buyers and sellers in lower-profit industries such as restaurants and retail, while Calder Capital represents middle market and lower market buyers and sellers in sectors such as manufacturing and technology with businesses valued at between $1 million and $100 million.

Friar said the firms, which have had a combined 12 closings so far in 2019 compared to 18 in all of last year, are tracking with the national report when it comes to sale multiples (data used to calculate the transaction value of a business), time to close (the length of time a deal takes to complete) and cash at close (which includes what buyers put into the deal from their balance sheet or financing and reduces the amount of seller financing needed).

For SBDA's completed deals, the year-to-date average purchase price for a business was $221,250. For Calder's, the average YTD purchase price was about $1.5 million.

The mean engagement to closing (EA to close) period for SBDA was 9.8 months, compared to the national average of eight months. Average EA to close was 8.58 months for Calder, about the same as the eight to nine months cited for the same market segments in the Market Pulse Report.

SBDA tracked an average cash at close rate of 69%, compared to the national rates between 85%-86%. Calder saw mean cash at close rates of 74%, about 10 percentage points lower than the national average.

Friar pointed to data in the report (see chart), which shows sale multiples peaked in Q1 2017.

"I don't want to sound pessimistic because there are a lot of businesses that are doing very well; they're making very good profits. I don't think the economy is on bad footing, but I think if you look … (at) the sentiment trend, you'll notice it is returning for the past couple of quarters (but) the multiples are going down," Friar said.

"I think what we might be seeing from this report is that the best times are behind us, but it's still good. It's hard to say in two years if things are going to be better."

He echoed Everett's advice to sell now or wait five to seven years until the market climbs again.

Other highlights from the report

Lower middle market companies in the $5 million-$50 million range had the highest final sale price, at 101% of benchmark.

Small businesses valued under $500,000 had the biggest drop from their asking price, with final sale prices going from 91% of the pre-set asking price in Q1 2017 to 85% in Q1 2019.

Nearly half (48%) of businesses that come to market do not sell.

The average time to close a deal is 8.8 months. The range is eight to 11 months.

Most small business owners fail to plan for the sale of their business. Advisers indicated 90% of business owners with enterprise value of less than $500,000 conducted no formal planning prior to engagement. Lower middle market business owners were more proactive, although about 48% also failed to make advance plans to sell. Advance planning can help sellers receive the highest market value and decrease the amount of time it takes to sell their business, according to the report.

Median multiple off peak. **Source: International Business Brokers Association, M&A Source and the Pepperdine Private Capital Market Project**

Median Multiple Paid (SDE)	**Q1 2019**	**Q1 2018**	**Q1 2017**	**Q1 2016**	**Q1 2015**	**Q1 2014**
<$500K	2.0	2.0	2.3	2.0	2.0	2.0
$500K - $1M	2.5	2.8	2.8	2.8	2.7	2.6
$1M - $2M	3.0	3.3	3.3	3.0	3.3	3.1
Median Multiple Paid (EBITDA)						
$2M - $5M	4.3	4.4	5.3	4.0	4.5	4.3
$5M - $50M	6.0	6.1	5.3	5.5	4.9	4.5

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