MARKET INSIGHTS:
The Tidal Wave That's Coming
Q1 - 2018

Where is that tidal wave of Canadian baby boomers putting their businesses up for sale? We've all heard about it, but we haven't seen it yet…so far, it's been more of a steady trickle. But like death and taxes, demographics are a certain thing and the wave will come. It's just a matter of when.

For you, as a business owner, the question is: how do you best navigate an environment where a glut of companies are for sale, particularly if you are contemplating an exit?

The Predictions and the Current Reality

In 2016, Canadian Business Magazine predicted that "the stage is set for the biggest intergenerational transfer of companies Canada has ever seen, as gen-Xers and millennials buy out the boomers." But the boomers haven't been selling or transitioning at the pace that was expected since that prediction.[1] Many entrepreneurs have been hanging onto their businesses rather than retiring for a variety of reasons: perhaps difficult years during the 2008 financial downturn forced them to delay retirement, or they just aren't ready yet, wanting to cement their legacy.

Nevertheless, the reality of our demographics is inevitably going to drive the wave of exits. It's just a matter of timing for that "rash of 'for sale' signs" to spread across the Canadian business landscape.

Given that the process of selling and fully exiting a business typically takes a year or more, and that it's obviously preferable to exit in a seller's rather than a buyer's market[2], we believe that the majority of entrepreneurs should be selling now to beat the wave. Our reasoning is simple: supply and demand, assessed on the basis of unfavourable business owner demographics and their need/intention to exit, on the one hand, and strong buyer appetite and ample availability of cheap capital, on the other.

Canadian Entrepreneurs: Demographics and Intentions

We hear it often: our "business" population is aging. According to Statistics Canada[3], almost 60% of small business owners are 50 years of age or older. That number jumps to 65% for medium business owners.[4]

With these demographics in mind, it was not surprising to learn that in a recent survey[5] of more than 2,500 entrepreneurs, 40% expressed an intention to exit their businesses in the next five years, primarily due to retirement. Of that 40%:

- Almost half planned to exit within three years; and
- More than half intended to sell to someone outside their family.

In Canada, there are 1.16 million small and medium enterprises (SMEs).[6] Granted, a large number of these are sole proprietorships, but let's extrapolate the survey results to the entire Canadian SME population: over the next five years, there could be 230,000 SMEs going up for sale to parties outside the business owner's family. Even if only a fraction of this 230,000 ceiling transact, it would equate to a massive increase in transaction volume (during a normal year in Canada, about 2,500 deals are reported). In other words, expect a sharp increase in supply.

In a 2017 BDC survey of 2,500 entrepreneurs, 40% planned on exiting within 5 years.

Buyer Appetite and Availability of Capital (Spoiler Alert: It's a Seller's Market)

With private equity firms (PE) holding an unprecedented US$954b (globally) in dry powder[7] that must be deployed within a limited time window, there is strong demand for acquisition targets. Strategic (corporate) buyers are also driving up competition for deals, propelled by a need to drive growth through acquisitions, and supported in their efforts by record levels of corporate cash balances.

Foreign buyers are showing stronger interest in acquiring Canadian mid-market firms[8], and anecdotally, we are witnessing mounting interest from (and facilitating deals with) US PE in the Canadian mid-market.

We don't see this demand abating in 2018. In addition to all that dry powder and balance sheet cash, the outlook is positive for Canadian M&A in the current year.[9] Bolstering this view, in a recent survey of global CEO's, Canada flew up through the rankings as an attractive country in which to pursue acquisitions.[10]

But all this positivity comes with a caution. There is consensus amongst recent major bank forecasts that Canadian economic growth could slow through 2018 and 2019, with at least one bank now predicting an increased risk of recession between 2019 and 2022.[11] If these forecasts prove to be accurate, expect a cooling effect on the current heated demand for Canadian acquisitions into 2019.

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What we know, and why acting now should be on your radar…

Currently, we are in a seller's market. But the tidal wave of business transitions is coming, which means a sharp increase in supply, which could be paired with a slowdown in domestic economic growth. This shift in dynamics should cause valuation multiples to decline.

Here is a thought exercise about what that might mean for you. For the next 12 months, a well-managed, steadily growing business can expect to sell for a 7-8x EBITDA multiple, when represented by an investment bank. But can it expect to sell for the same multiple in 5 years? With the rather certain increase in supply and a possible weakening of the business environment, it's a conceivable (but not the only) scenario that multiples drop to 5x for the same business.

To drive the point home: even a 10% increase in EBITDA every year during those 5 years - not a small feat - won't offset that multiple decline. Conversely, it also means that a business that can confidently grow at that pace should hold on for the ride.

Exit Year	2018	2022
EBITDA Multiple	7.5x	5x
EBITDA	$3m	$4.4m
Enterprise Value	$22.5m	$22.0m

We don't have a crystal ball. Another possible scenario is that demand for acquisitions accelerates and outstrips the new supply of business up for sale, and multiples remain elevated. From where we stand, though, beating that tidal wave of exits and avoiding wishful thinking about the mid-term outlook for M&A, doesn't look like a bad strategy. If you're thinking about an exit, this is a good time to make it happen.

RECENT TRANSACTIONS

MARCH 2018

Pita Pit

Debt Financing for Acquisition

The undersigned acted as the exclusive advisor to the company

FIREPOWER CAPITAL

DECEMBER 2017

ECi Software Solutions

Acquired

PRINTFLEET

The undersigned acted as the exclusive advisor to the seller

FIREPOWER CAPITAL

DECEMBER 2017

EquiSoft

Acquired

Apeiron Software

The undersigned acted as the exclusive advisor to the seller

FIREPOWER CAPITAL

DECEMBER 2017

lastcall Analytics

Growth Equity

The undersigned is an investor in the company

FIREPOWER CAPITAL

ABOUT FIREPOWER CAPITAL

FirePower Capital is the investment banking and private capital firm built for Canada's entrepreneurs. Our team of 30+ deal-makers help their mid-market businesses complete mission-critical transactions.

For more information and resources please visit www.firepowercapital.com.

FOOTNOTES

1. *According to data sourced from Cap IQ, there has not been a meaningful surge in deal volume in the lower mid-market that could be characterized as a "wave" phenomenon. Anecdotally, FirePower has seen Increased interest, but that has yet to translate into significantly higher deal volume.*
2. *Valuation multiples still point to a seller's market. For example, see Pitchbook's 2017 Annual US PE Middle Market Report.*
3. *Statistics Canada, Survey on Financing and Growth of Small and Medium Enterprises, 2014; and Innovation, Science and Economic Development Canada calculations. https://www.ic.gc.ca/eic/site/061.nsf/eng/h_03018.html#figure8-2-1*
4. *Small business is defined as one with 1-99 employees; medium business employs 100-499.*
5. *The Coming Wave of Business Transitions in Canada; BDC, September 2017*
6. *Key Small Business Statistics – June 2016, Government of Canada*
7. *Prequin Quarterly Private Equity Update – Q3 2017*
8. *According to data sourced from Capital IQ, in Q4, 2017, there was a 13% increase in foreign acquisitions of Canadian targets compared to Q4, 2016.*
9. *Reaching New Heights: The Outlook for Canadian M&A in 2018, Mergermarket*
10. *PWC's 21st Annual Global COE Survey: The Anxious Optimist in the Corner Office.*
11. *Scotiabank Global Economics Long-Term Outlook, November 2017*