

# **State of Middle Market M&A 2017**

*The Capstone Strategic Report*

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## Executive Summary

Capstone conducts an annual survey of company owners and executives to elicit their perspective on M&A and external growth in the middle market. The 2017 report is our fourth in this series. It follows the same format and includes many of the same questions. New questions have been added to reflect our most recent work with clients seeking growth through M&A.

## Key Findings

1. **M&A activity** across the board is mostly seen as the same (43%) or growing (31%).
2. **Looking forward**, our respondents are evenly split on whether or not they will pursue M&A in 2017. 35% less than 50% likely to execute acquisitions and 35% are more than 50% likely.
3. The **top driver for pursuing M&A in 2017** is access to new markets (47%).
4. Time and attention demanded by the process is the top **barrier to pursuing M&A in 2017** (25%).
5. The most common reason for **not considering M&A as a tool for growth** is lack of appropriate target companies (28%).
6. The **overall growth picture is improving**. Those reporting modest growth rose from 58% in 2015 to 67% in 2016 and those reporting high growth grew from 11% in 2015 to 13% in 2016. Those reporting contraction shrunk from 9% in 2015 to 5% in 2016.
7. The **business environment** is seen by most in a positive light, with the majority reporting the same (50%) or an improved (35%) environment for growth. Compared to last year, fewer executives saw a worsening environment for growth (8% compared to 13%).

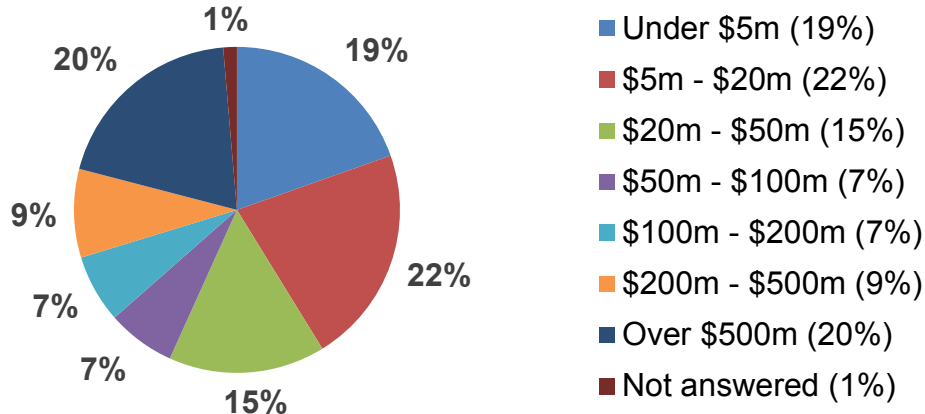
## Middle Market M&A Activity in 2016

2016 remained an active year for middle market mergers and acquisitions with most respondents reporting the same or growing M&A activity in their industry. However, uncertainty over the U.S. presidential election as well as a more positive environment for organic business growth meant fewer executed acquisitions in 2016 than in 2015. As the political and economic landscape stabilizes we expect a renewed interest in pursuing acquisitions.

## About the Survey

Capstone polled a sample of 148 business leaders in the middle market, in 45 industries. Businesses ranged in size from under \$5m to over \$500m revenues. Our respondents were primarily CEOs and owners, along with other C-level executives. The survey was conducted in December 2016.

### What is the size of your company in revenues?



### Industries Represented

- |                                 |                            |                                 |
|---------------------------------|----------------------------|---------------------------------|
| Accreditation                   | Financial Services         | Packaging                       |
| Aerospace/Defense               | Food and Beverage          | Plastic Film                    |
| Agriculture                     | Government Contracting     | Printing                        |
| Asset Management                | Healthcare                 | Private Equity                  |
| Automotive                      | High Performance Materials | Professional Services           |
| Chemicals                       | Information Technology     | Property Management             |
| Chemistry                       | Insurance                  | Real Estate                     |
| Construction                    | Investment Banking         | Recreation                      |
| Consulting                      | Legal                      | Relocation Support Services     |
| Consumer Packaged Goods         | Manufacturing              | Semiconductor Capital Equipment |
| Contract Manufacturing          | Media                      | Service                         |
| Data Analytics                  | Metal Processing           | Software                        |
| Electroforming / Vacuum Coating | Nonwovens                  | Trading and investments         |
| Electronics                     | Not for Profit             | Training                        |
| Energy                          | Oil and Gas                | Warehousing and distribution    |

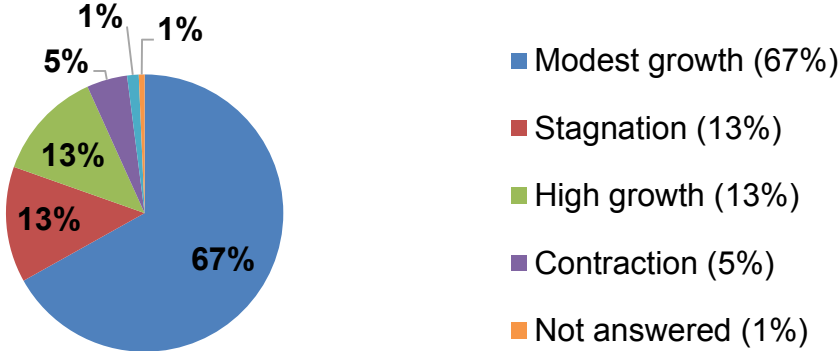
# The Growth Picture

We asked our respondents to review the outlook for their respective industries. The data suggest the overall growth picture is improving and respondents are optimistic about growth.

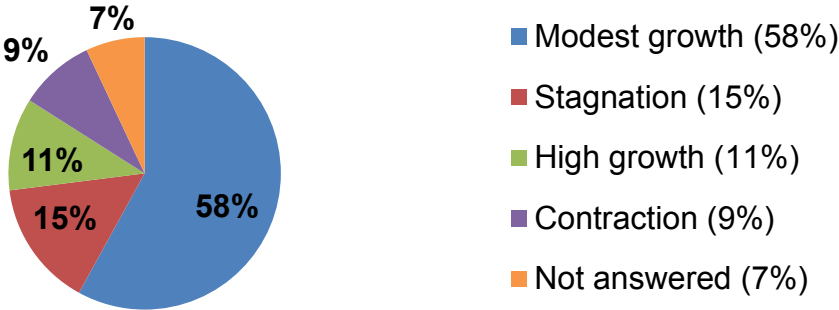
Consistent with previous years, we saw that most observed modest growth. In 2016, 67% saw modest growth compared to 58% in 2015. While only 13% reported high growth, this was an increase from 2015 (11%). Fewer also saw contraction and stagnation in 2016 than in 2015.

## How would you rate current growth in your industry as a whole?

### 2016



### 2015

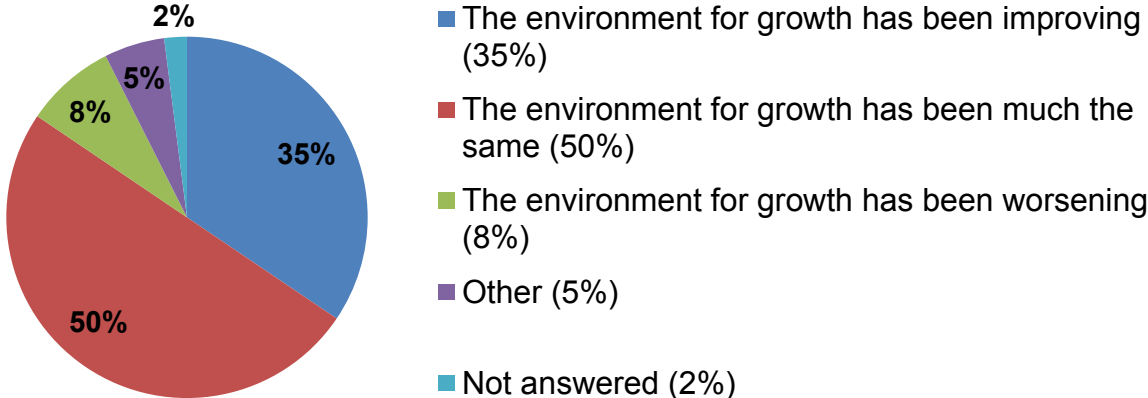


Similarly, respondents were generally positive about the environment for future growth; most saw the same or an improving environment. One respondent commented that their company had “never done better.”

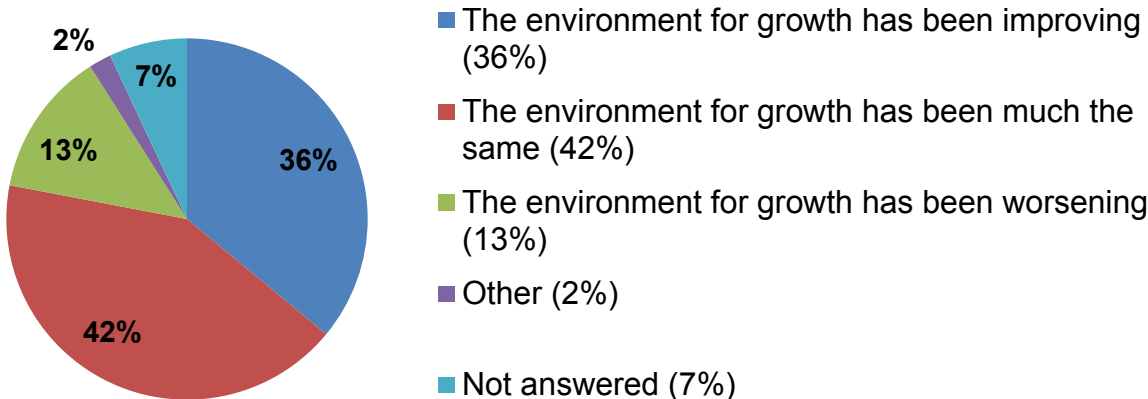
When compared to last year, about the same percentile saw an improving environment (35% in 2016 vs. 36% in 2015) while those reporting the same environment for growth increased (from 42% to 50%). The number reporting a worsening environment dropped (from 13% to 8%).

Interestingly, one respondent stressed the need for business leaders to remain proactive saying, “The environment has been good for growth, but the industry has not capitalized on it.” Successful business leaders must do more than rely on favorable market dynamics in order to grow.

***How would you describe the environment for growth in 2016?***



***How would you describe the environment for growth in 2015?***

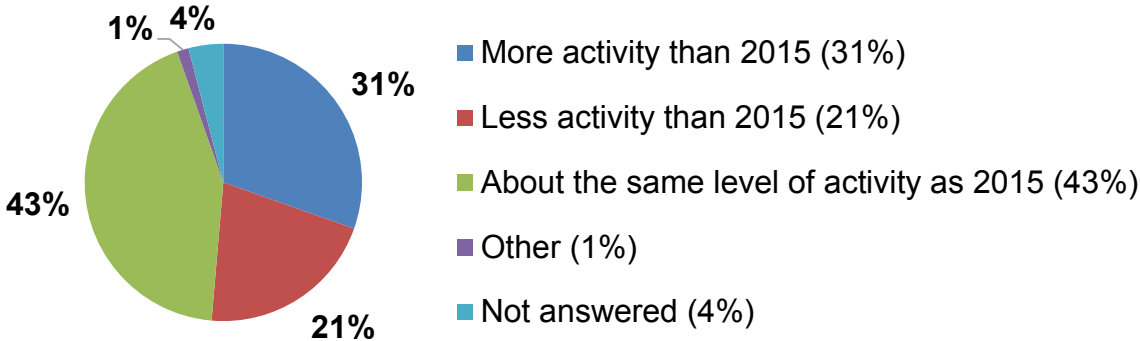


Responses may not add up to 100% due to rounding

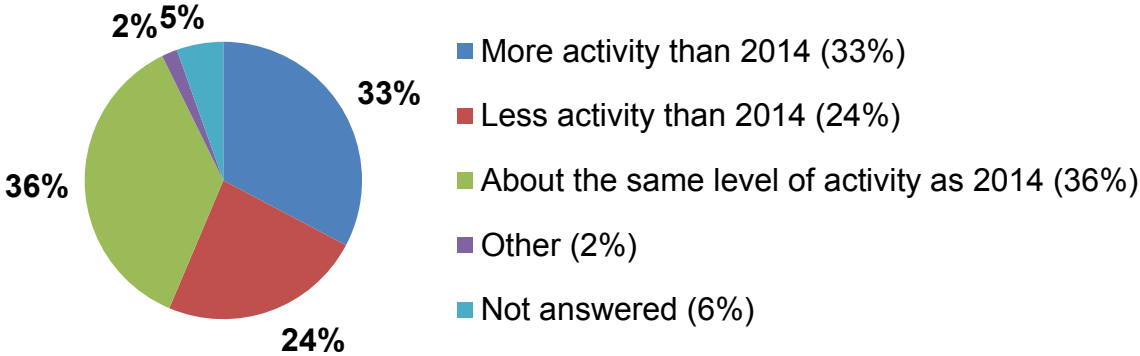
# M&A Activity

2015 was a record-breaking year with \$4.4 trillion of deals announced worldwide. The survey suggest that M&A in the middle market remained strong in 2016 as well. Most (43%) reported about the same level of M&A activity in their industry in 2016, an increase from last year (36%). While slightly fewer reported more activity in 2016 (31%) than in 2015 (33%) fewer also reported less activity (21% vs 24%).

## In your industry, how much M&A activity did you see in 2016?



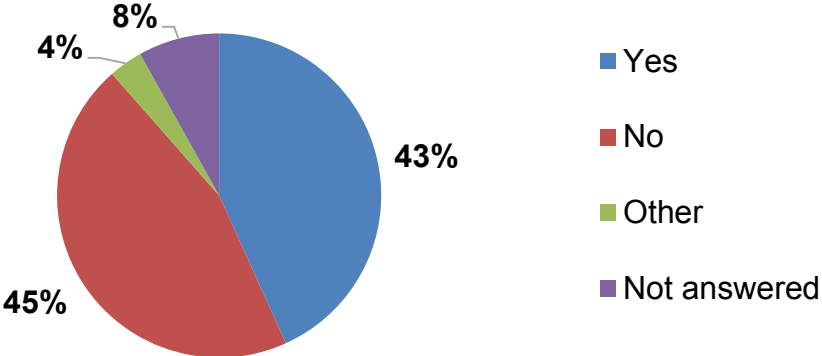
## In your industry, how much M&A activity did you see in 2015?



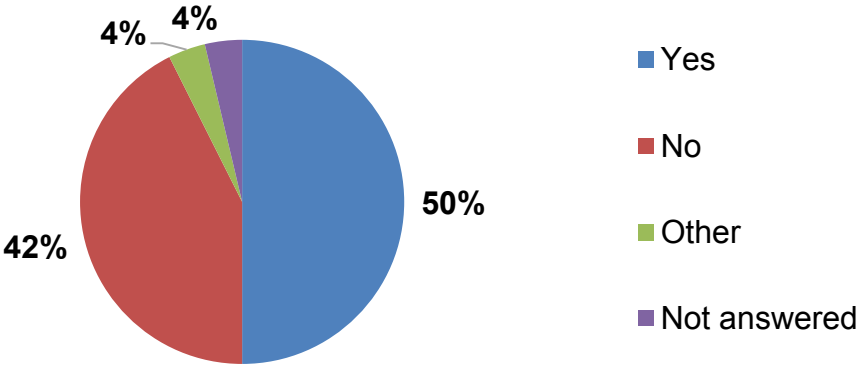
Responses may not add up to 100% due to rounding

Those who engaged in M&A in 2016 dropped (from 50% to 43%) when compared to 2015. Fewer respondents may have participated in M&A in 2016 due to uncertainty caused by the U.S. presidential election and global economic events.

***Has your company engaged in any M&A or external growth activities during 2016?***



***Has your company engaged in any M&A or external growth activities during 2015?***

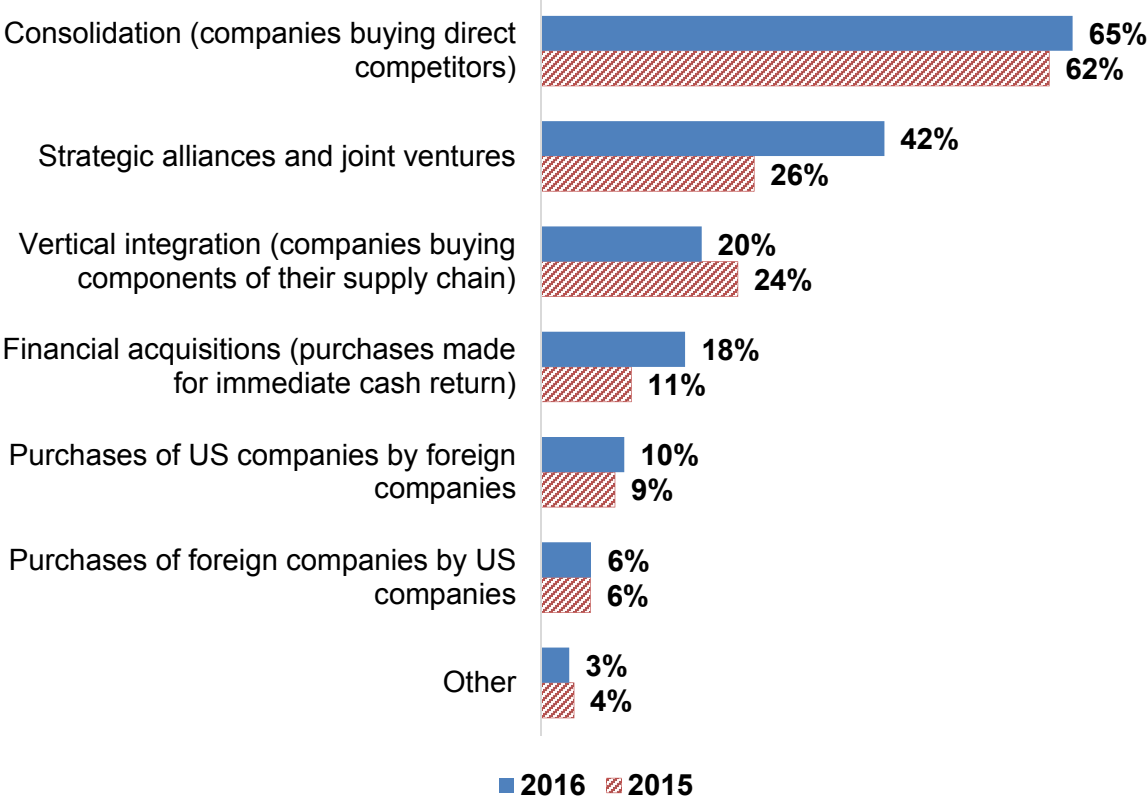




As for the types of M&A activity reported, consolidation was clearly the most common focus (65%) with strategic alliances and joint ventures following in second place (42%). Vertical integration came in third (20%) and financial acquisitions followed closely at fourth (18%).

When compared to last year’s survey the results were strikingly similar. The most interesting variation was the increased interest in strategic alliances and joint ventures in 2016.

***In your industry, which kinds of M&A activity did you see most of in 2016?***



Multiple responses allowed per respondent.

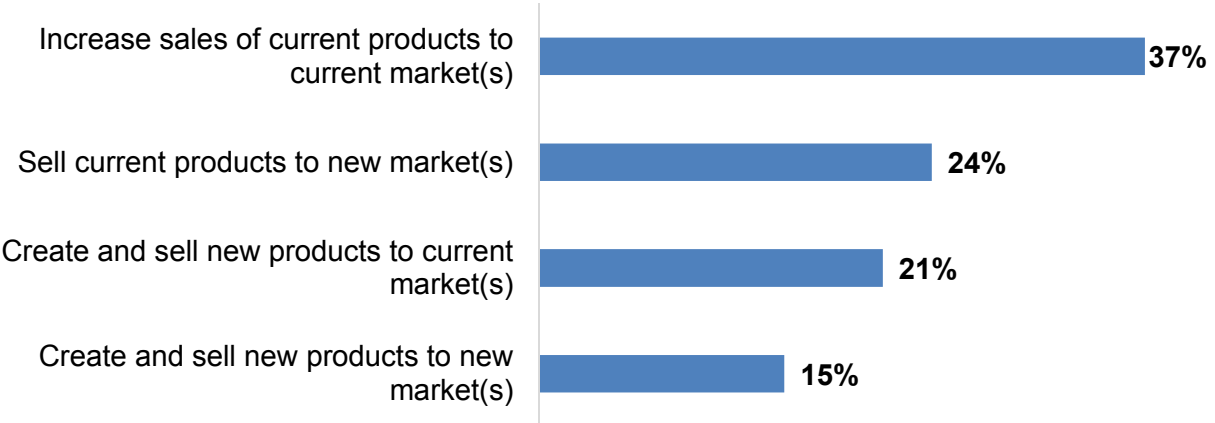
# M&A Motivations

Capstone uses a tool called the Opportunity Matrix to help develop an external growth strategy. We shared this tool in the form of a question, asking our respondents which of four options was most attractive to them. As expected, most of the survey respondents were interested in increasing sales of current products to current markets (37%) and the fewest (15%) were interested in selling new products to new markets, which is typically riskier.

## The Opportunity Matrix

		Markets / Customers	
		Existing	New
Products / Services	Existing	Increase sales of existing products to existing markets	Sell existing products to new markets
	New	Sell new products to existing markets	Sell new products to new markets

### Which kind of growth is most attractive to your company right now?



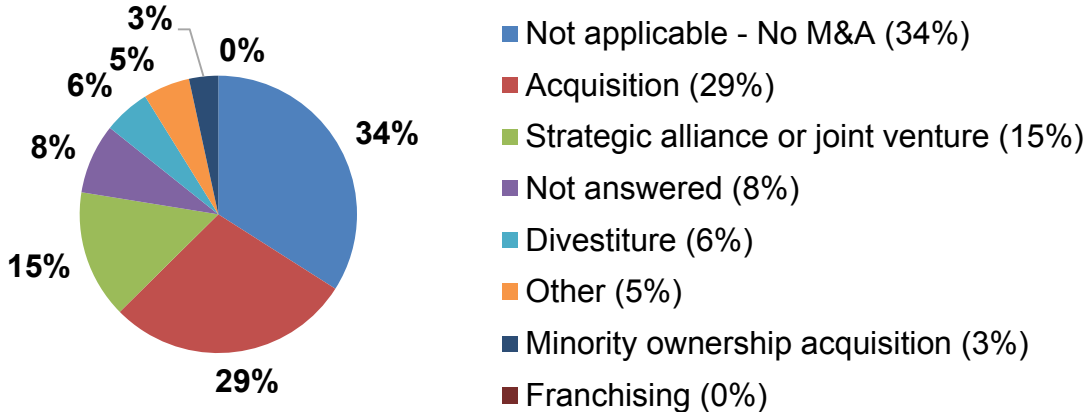
Multiple responses allowed per respondent

As for the kinds of external growth that are attractive to our respondents, of those who engaged in M&A, acquisition is the clear leader (29%) with strategic alliance or joint venture (15%) coming in second. A few respondents were also interested in divestiture (6%) and minority ownership (3%).

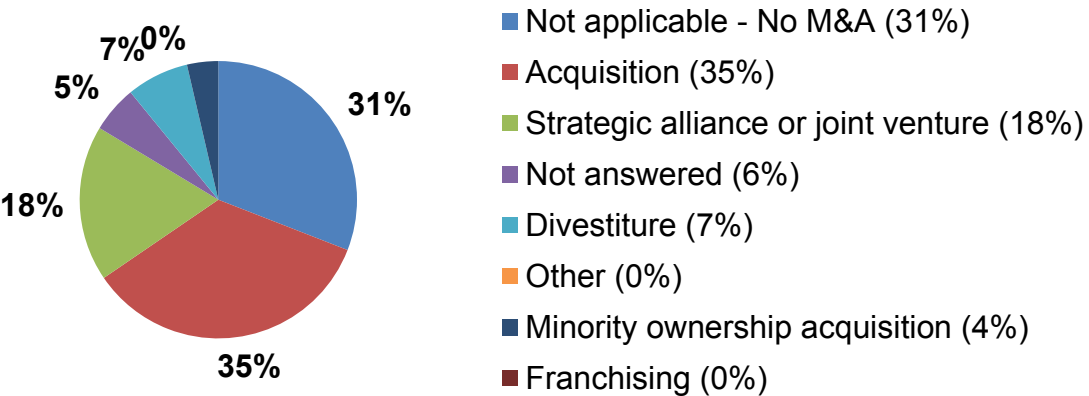
Fewer respondents in 2016 engaged in external growth than in 2015. In 2016 34% compared to 31% in 2015 said they did not engage in M&A in the past year. Some respondents noted they attempted acquisitions in 2016, but the deals fell through or were blocked by regulation.

For those who did engage in M&A, the types of activity remained similar year to year with acquisition and strategic alliances or joint ventures remaining the most popular form of external growth.

**Which of these specific activities has your company engaged in this past year?  
2016 responses**



**2015 responses**

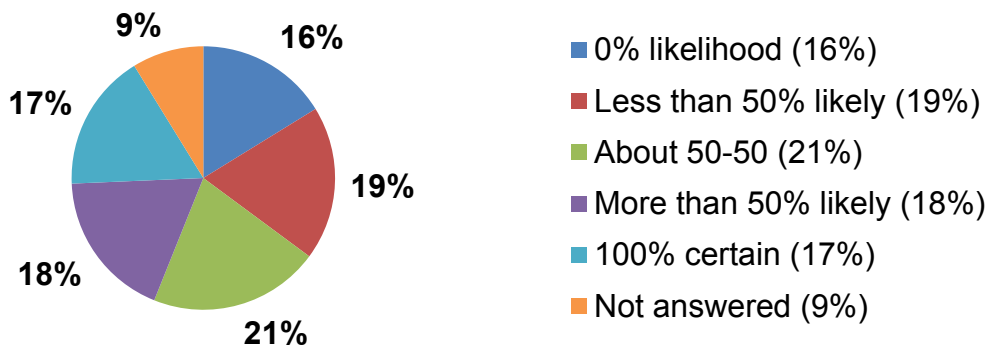


## Looking Forward to 2017

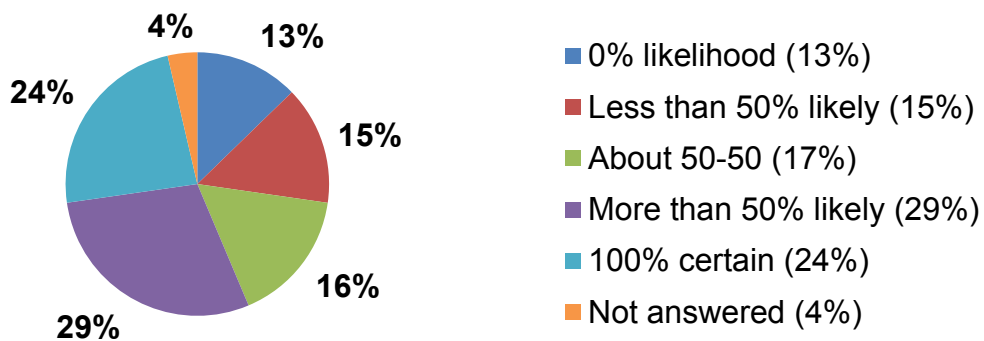
We see a mixed picture when it comes to pursuing M&A in 2017. 35% are 0% likely (16%) or less than 50% likely (21%) to execute acquisitions and 35% are more than 50% likely (18%) or 100% likely (17%). 21% are on the fence.

Compared with the last year's survey those who are 100% certain of engaging in M&A declined (from 24% to 17%) and those who are more than 50-50 sure of M&A in the coming year dropped (from 29% to 18%). Those who will not engage in M&A in 2017 rose (from 13% to 16%).

### *How likely is it that your company will pursue some form of M&A or external growth in 2017?*

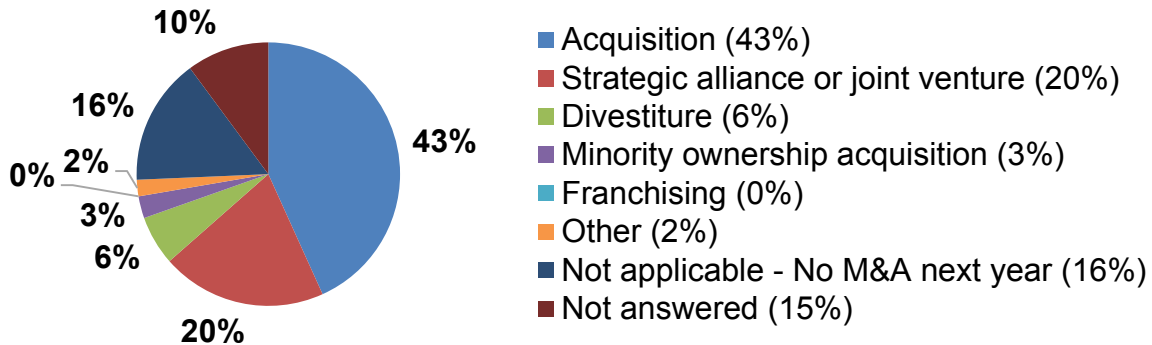


### *How likely is it that your company will pursue some form of M&A or external growth in 2016?*

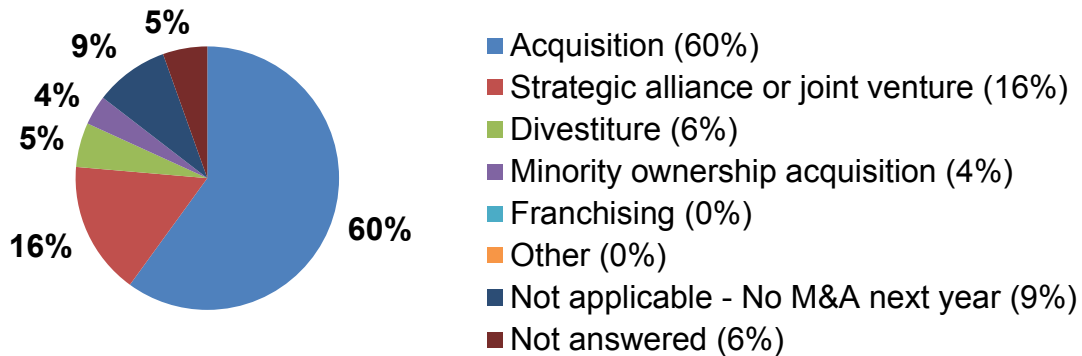


As might be expected, those looking to participate will mostly be focused on acquisition, with a smaller number interested in strategic alliances and JVs. Compared to last year, interest in acquisition declined (from 60% to 43%), but interest in strategic alliances and joint ventures rose (from 16% to 20%). A small number of respondents remained interested in divestiture (6%) and minority ownership (3%).

***If you expect your company to engage in M&A in 2017, which of the following is most likely?***



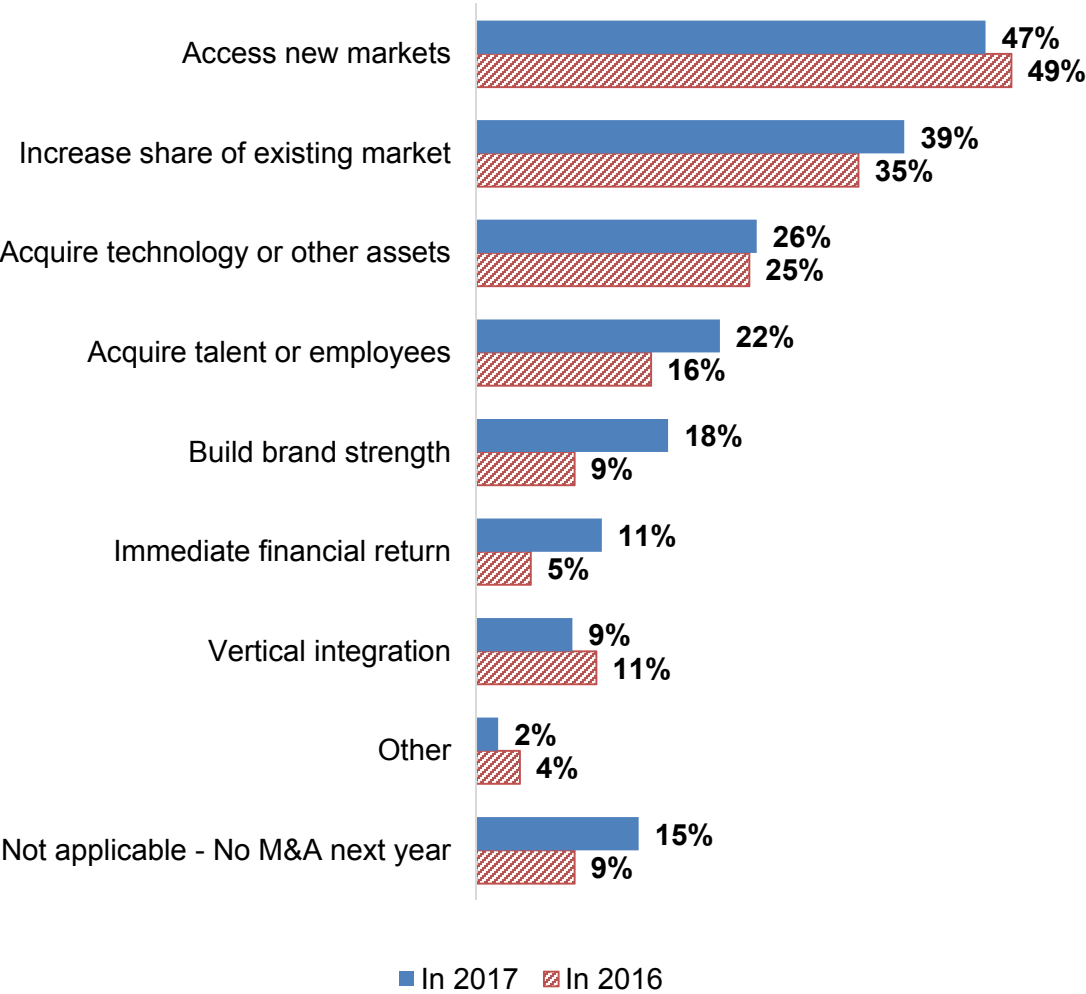
***If you expect your company to engage in M&A in 2016, which of the following is most likely?***



Access to new markets remained the biggest driver for those eager to pursue M&A in 2017 (47%), increase share of existing market was a strong second (39%) followed by acquire technology or other assets (26%) and acquire talent or employees (22%).

The top responses remained the nearly the same when compared to the last time we asked this question (looking forward to 2016). In this year’s survey a number noted exit for the current owner or retirement as a motivator for M&A.

***If your company is likely to engage in M&A or external growth in 2017, which of these is the most likely reason?***



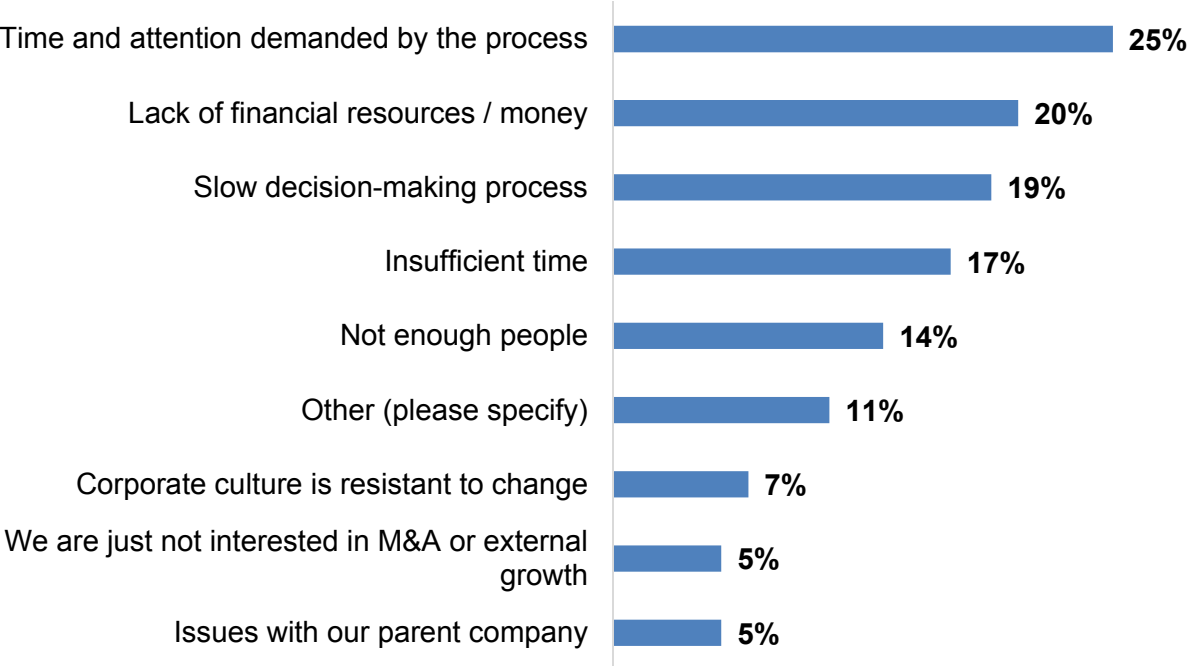
Multiple responses allowed per respondent

# Barriers to M&A

What holds owners and executives back from using M&A to grow their companies? The most common answer (25%) is time and attention demanded by the process followed by financial resources (20%) and slow-decision making process (19%).

Previous transactions were also were a barrier to pursuing M&A. One company was still in the process of completing a merger from 2016 and another was facing “integration challenges with previous acquisitions.” Since an acquisition can be a huge undertaking, it is not unusual for companies to take some time to digest and recalibrate before moving on to the next deal.

## *For your company, what are the likeliest reasons NOT to pursue M&A or external growth in 2017?*

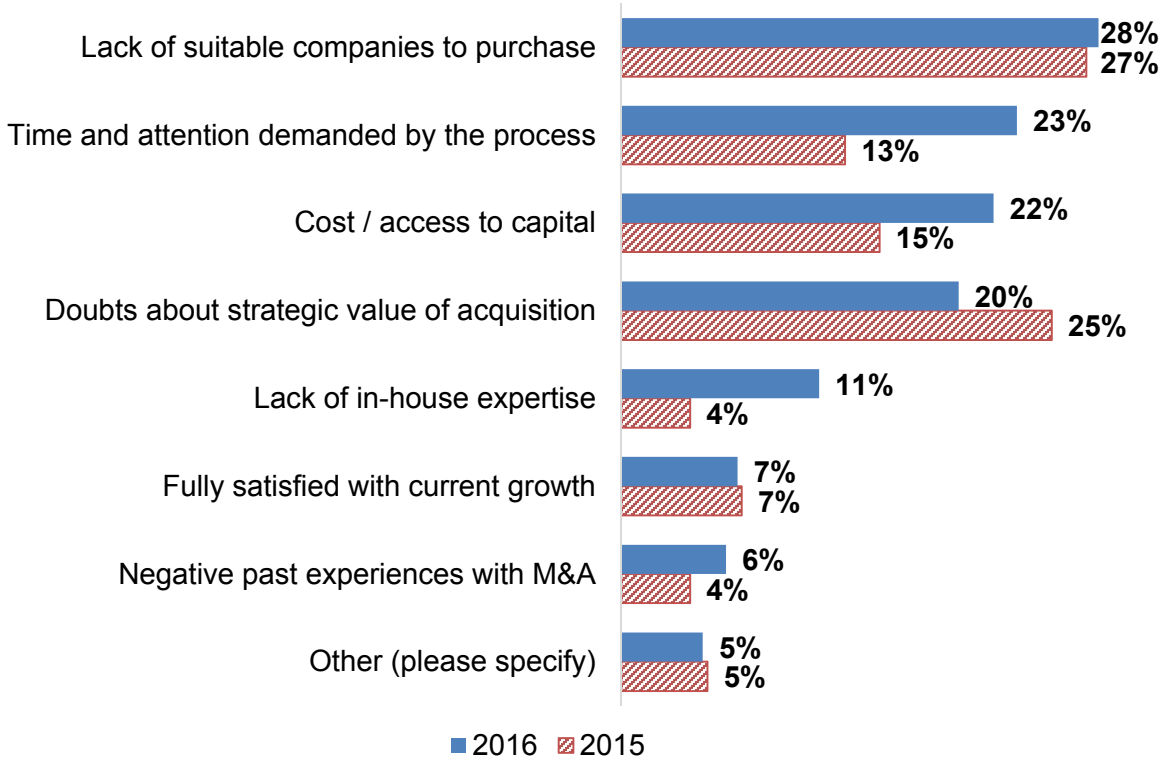


Multiple response allowed.

Respondents noted that the most common reason for not using M&A was lack of appropriate target companies (28%). The lack of targets may well come from only considering for-sale companies: once the universe of not-for-sale companies is opened, it is rare to find a lack of potential acquisitions. Of course, what's needed then is a methodology for buying not-for-sale entities.

Time and attention demanded by the process (23%) and cost/access to capital (22%) came in second and third. The challenge of finding enough time and attention to pursue M&A is a common one faced by many middle market companies who typically do not have a dedicated acquisitions department and may lack the experience needed to move the deal forward.

***What do you see as the strongest reasons for NOT considering acquisition as a tool for growth?***



Multiple responses allowed per respondent



## Conclusions

Coming off a record year for M&A in 2015, activity remained robust in 2016. Most saw similar levels of activity in their industry when compared to the previous year. However, fewer survey respondents executed acquisitions in 2016 than in 2015. It's likely a number of factors contributed to this. In 2016, our survey respondents enjoyed a more positive business environment and perhaps did not feel the need to execute acquisitions in order to grow. At the same time, there may have been hesitation to execute deals due to uncertainty over the U.S. presidential election.

Unfortunately the time and attention demanded by M&A and lack of suitable companies to buy are the top reasons middle market companies do not pursue acquisitions as a growth strategy. While, it is natural for business leaders to address the immediate day-to-day needs of running a company, it is also important to take a step back and think about long-term growth. Dedicating resources, including time, to strategic acquisitions can help rapidly position a business for future success.

As for finding the right company to acquire, owners and executives should expand their search beyond for-sale companies. Every company is for sale, for the right equation and a not-for-sale acquisition with a strong strategic fit may be the pathway to a successful transaction.

Looking to 2017, the middle market is prepared to embrace M&A as a growth strategy. Most remain interested in using M&A and external growth to access new markets and increasing their existing market share. Companies experiencing modest or high growth in their markets have the opportunity to leverage their strong position to continue driving growth (both organic and M&A).

## About Capstone

Capstone is the leading M&A advisory firm for the middle market focused on helping companies through strategic mergers and acquisitions. We have over 20 years' experience and have facilitated over \$1 billion in completed transactions. Capstone utilizes a systematic and proven process, developed over many years of practice, called the Roadmap to Acquisitions to provide tailored services to clients in a broad range of domestic and international markets.

To execute its programs, Capstone offers clients an integrated team of highly qualified consultants, researchers, analysts and support staff. To learn more about our services, call us for an exploratory conversation at 703-854-1910 or visit our website:

[www.CapstoneStrategic.com](http://www.CapstoneStrategic.com).