

# **State of Middle Market M&A 2020**

*The Capstone Strategic Report*

March 2020

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## Executive Summary

Capstone conducts an annual survey of company owners and executives to elicit their perspective on mergers and acquisitions (M&A) and external growth in the middle market. The 2020 report is our seventh in this series. Previous reports can be viewed on our [website](#).

## Key Findings

1. **Growth was generally positive** in 2019. In their industries, most respondents (71%) reported modest growth, similar to 2018 data (73%).
2. Respondents who engaged in M&A in 2019 dropped (from 52% to 41%) when compared to 2018.
3. Participants observed almost **similar levels of M&A activity in both 2018 and 2019** with **38% and 35%**.
4. Acquisition remains the most popular form of external growth, with a whopping 59% in 2019 compared to 49% in 2018.
5. **Time and attention demanded by the process (34%)** and lack of suitable companies to purchase (40%) were the top 2 barriers to M&A faced by participants.
6. Of the 41% who pursued M&A in 2019, the majority executed acquisitions (58%).
7. The **top driver for pursuing M&A in 2020** is to increase share of existing markets (71%).

## **M&A Activity Remains Modest, and COVID-19 Will**

### **Likely Impact 2020**

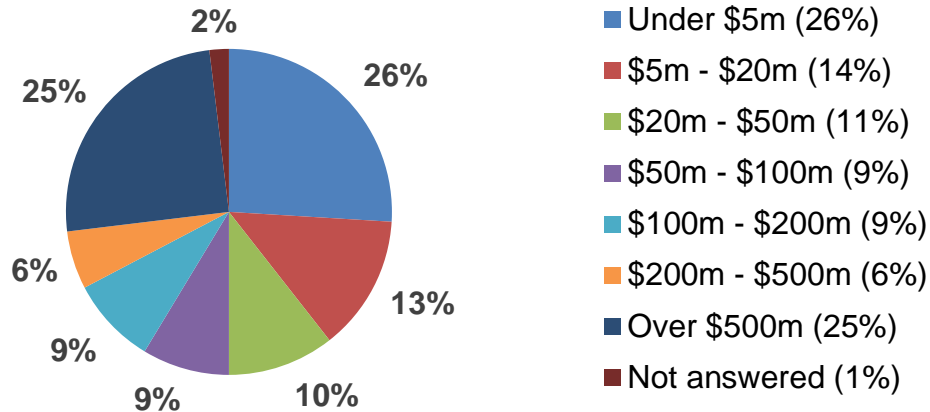
As anticipated in last year's State of the Middle Market M&A Report, the acquisition activity in 2019 did not reach the 2018 levels. The number of respondents who engaged in M&A in 2019 dropped from 52% to 41% when compared to 2018. Global merger and acquisition activity hit \$3.9 trillion in 2019 according to data provider Refinitiv. This represents a 3% decrease from 2018. Activity was majorly driven by megadeals (transactions valued at more than \$10 billion). Megadeals represented 31% of the global total, a sizable jump from 2018. In this year's survey, participants are still positive about growth in their industries. Compared to last year, a greater percentage of respondents are certain they will pursue M&A this year (21% compared to 11%).

Given the responses from our survey participants and our own observations of the marketplace, we predict M&A deals to be significantly down from 2019. According to Dealogic, the global M&A market is already set for its slowest first two months of a year since 2005. Analysts, state that coronavirus (COVID-19) fears will further impact the M&A market.

## About the Survey

Capstone polled a sample of 104 business leaders in the middle market in a wide spread of industries. Businesses ranged in size from under \$5m to over \$500m in revenue. Our respondents were primarily CEOs and owners, along with other C-level executives. The survey was conducted in January and February 2020.

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



### Industries Represented

Aerospace & Defense	Food Manufacturing	Medical Device Manufacturing
Agriculture	Government Contracting	Physical Therapy
Architecture	Healthcare	Plastics
Automotive	High Tech	Pool & Spa
Business Brokerage	Home Inspection	Private Investigations
Chemicals	Industrial Equipment Rental	Professional Services
Conference Centers	Information Technology	Real Estate
Conglomerate	Ingredients	Retail
Construction	Insurance	Road Deicing & Dust Control
Consulting	Janitorial Services	Rubber
Data Analytics Consulting	Legal	Senior Living
Education	M&A / Investment Banking	Test & Measurement Equipment
Emergency Management Response	Machinery & Metal	
Energy	Manufacturing	Transportation / Logistics
Engineering	Marketing	Water Treatment
Finance	Media	Wholesale Distribution
		Wholesale Foods

\* Some industries have been consolidated for this report

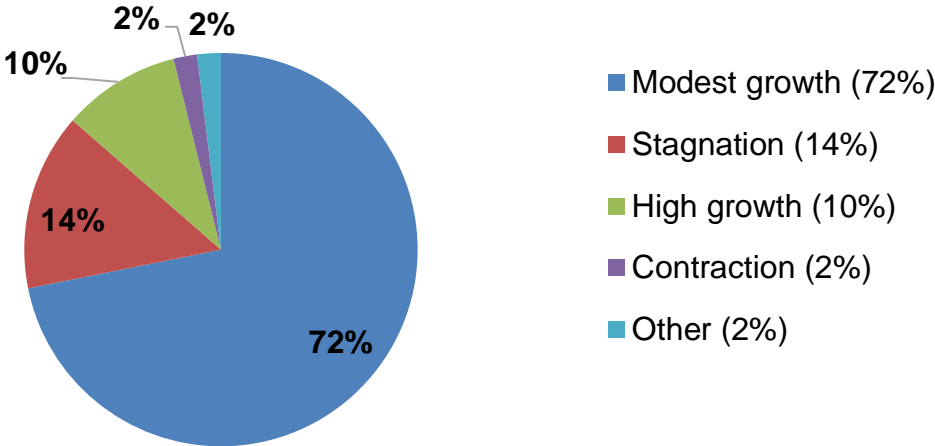
# The Growth Picture

Growth was generally positive in 2019 with most respondents observing a positive growth picture in their industries. A similar percentage reported modest growth in 2019 and 2018 (72% compared to 73%).

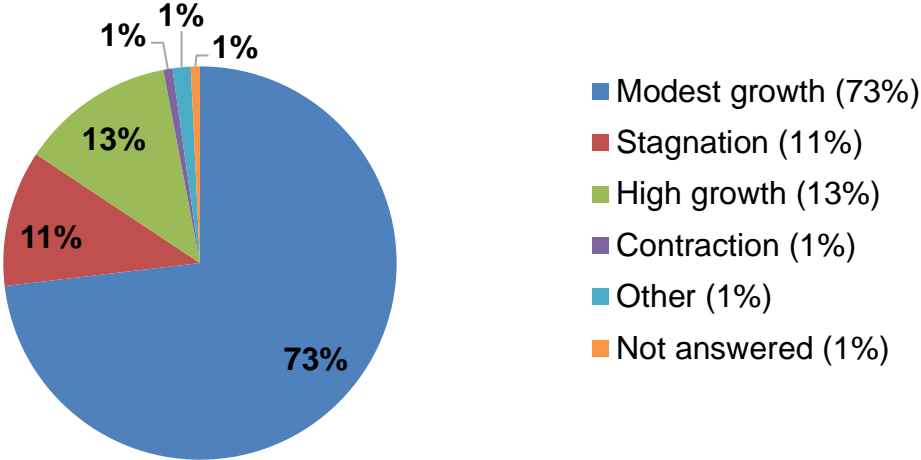
Only 10% reported high growth in 2019, as compared to 13% in 2018. Contraction and stagnation, both increased by 1% in 2019.

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

### 2019 responses



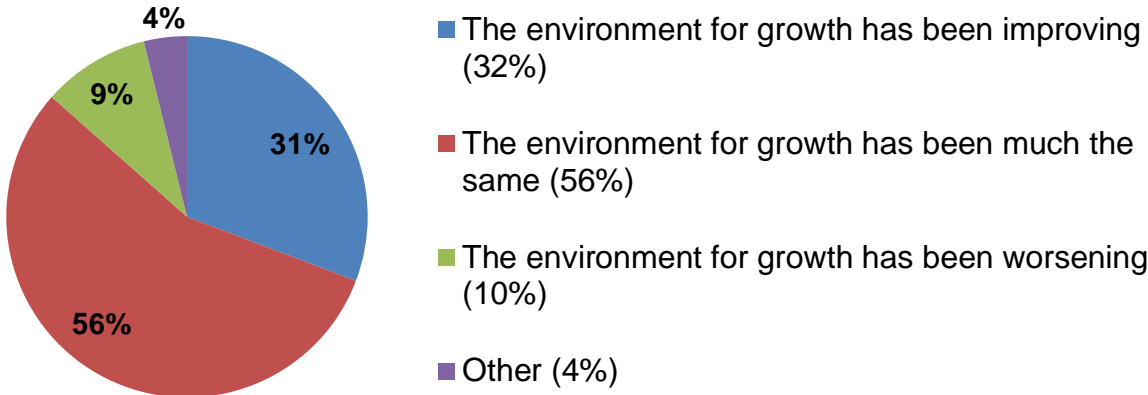
### 2018 responses



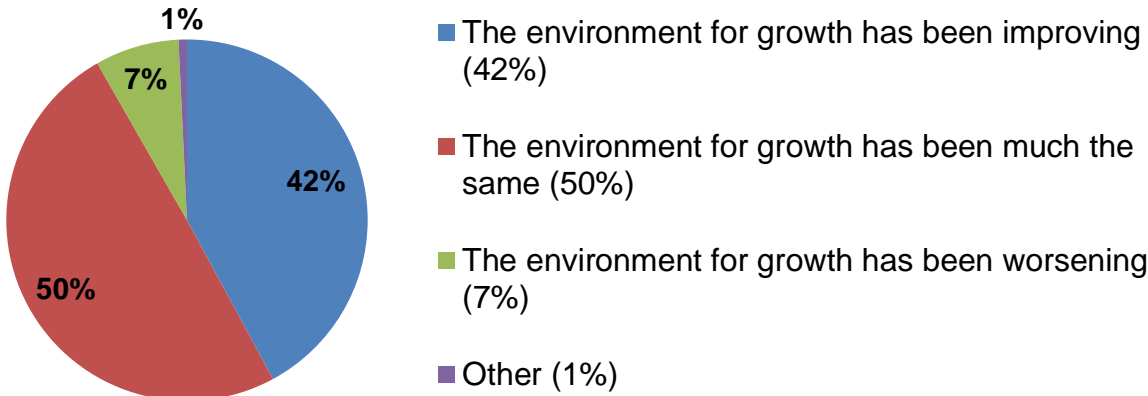
Responses may not add up to 100% due to rounding

The majority of respondents (56%) reported the environment for growth has been much the same in 2019, up by 6% from 2018. Meanwhile the percentage reporting an improving environment for growth dropped by 11% in 2019 while the percentage reporting a worsening environment remained relatively flat (9% in 2019 vs. 7% in 2018). Although fewer saw an improving growth environment, the responses suggest a stable growth environment for businesses across industries.

***How would you describe the environment for growth in 2019?***



***How would you describe the environment for growth in 2018?***



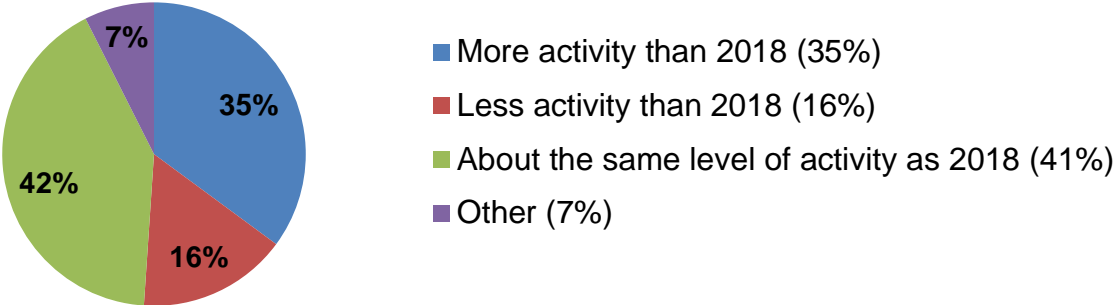
*Responses may not add up to 100% due to rounding*

# M&A Activity

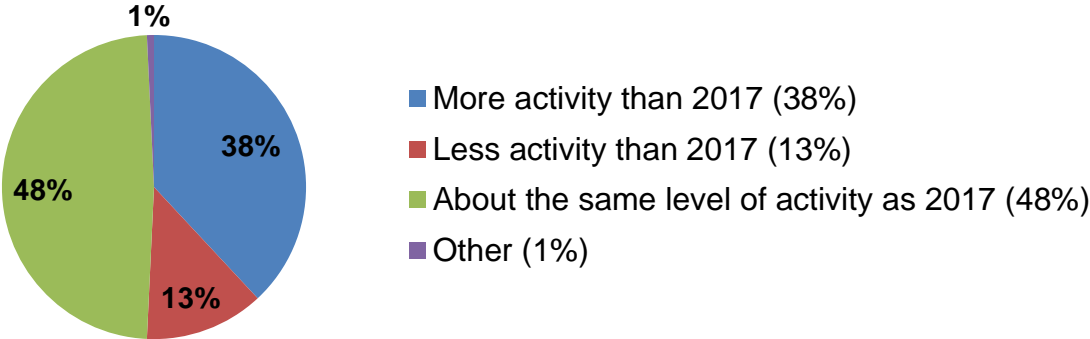
M&A activity remained modest in 2019 with most respondents reporting the same level of activity (42%) or more activity (35%) than the previous year. Just 16% reported less activity in 2019 compared to 2018. The survey data from the last four years suggests M&A activity has been growing since 2016 and has continued to be steady. It grew from 31% in 2016 to 38% in 2017. It remained the same in 2018 with 38% and then dropped a little to 35% in 2019.

*In your industry, how much M&A or external growth (acquisition, divestiture, joint venture, minority ownership, franchising) activity did you see in 2019?*

## 2019 responses

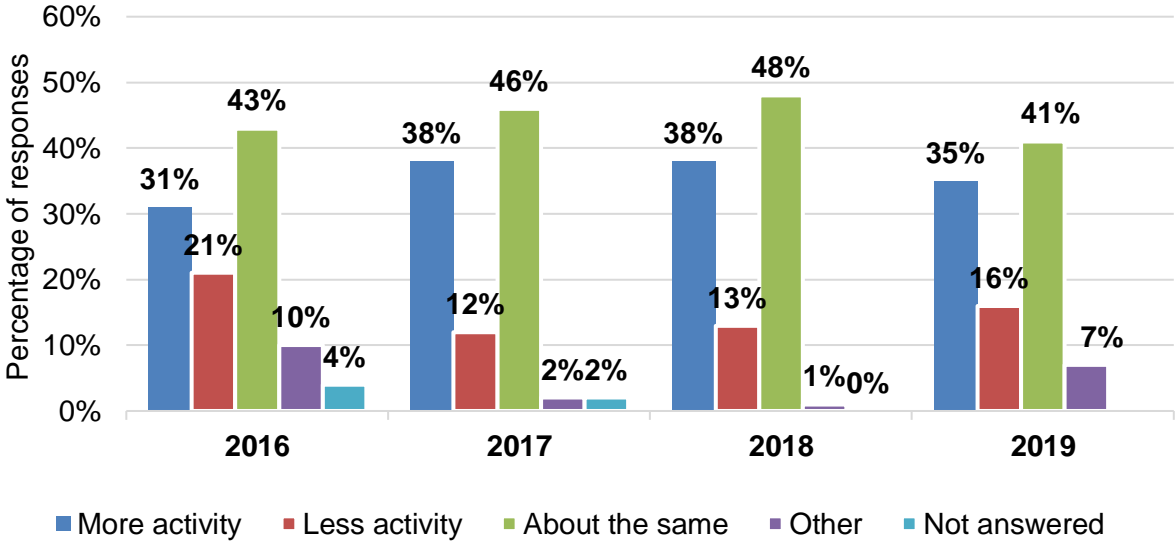


## 2018 responses





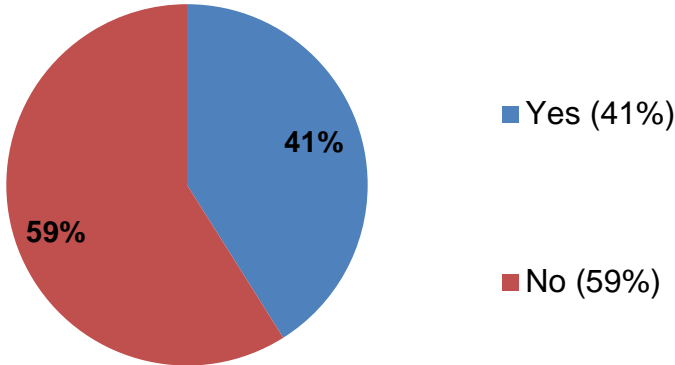
### M&A Activity Reported by Year



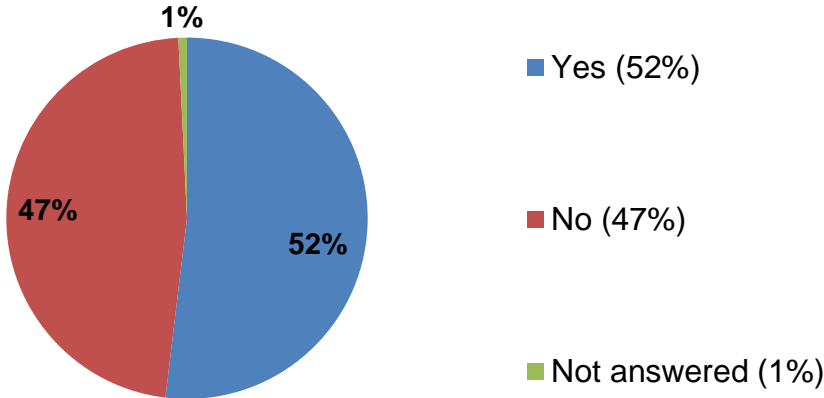
Responses may not add up to 100% due to rounding

Those who engaged in M&A in 2019 dropped (from 52% to 41%) when compared to 2018.

***Has your company engaged in any M&A or external growth activities in 2019?***

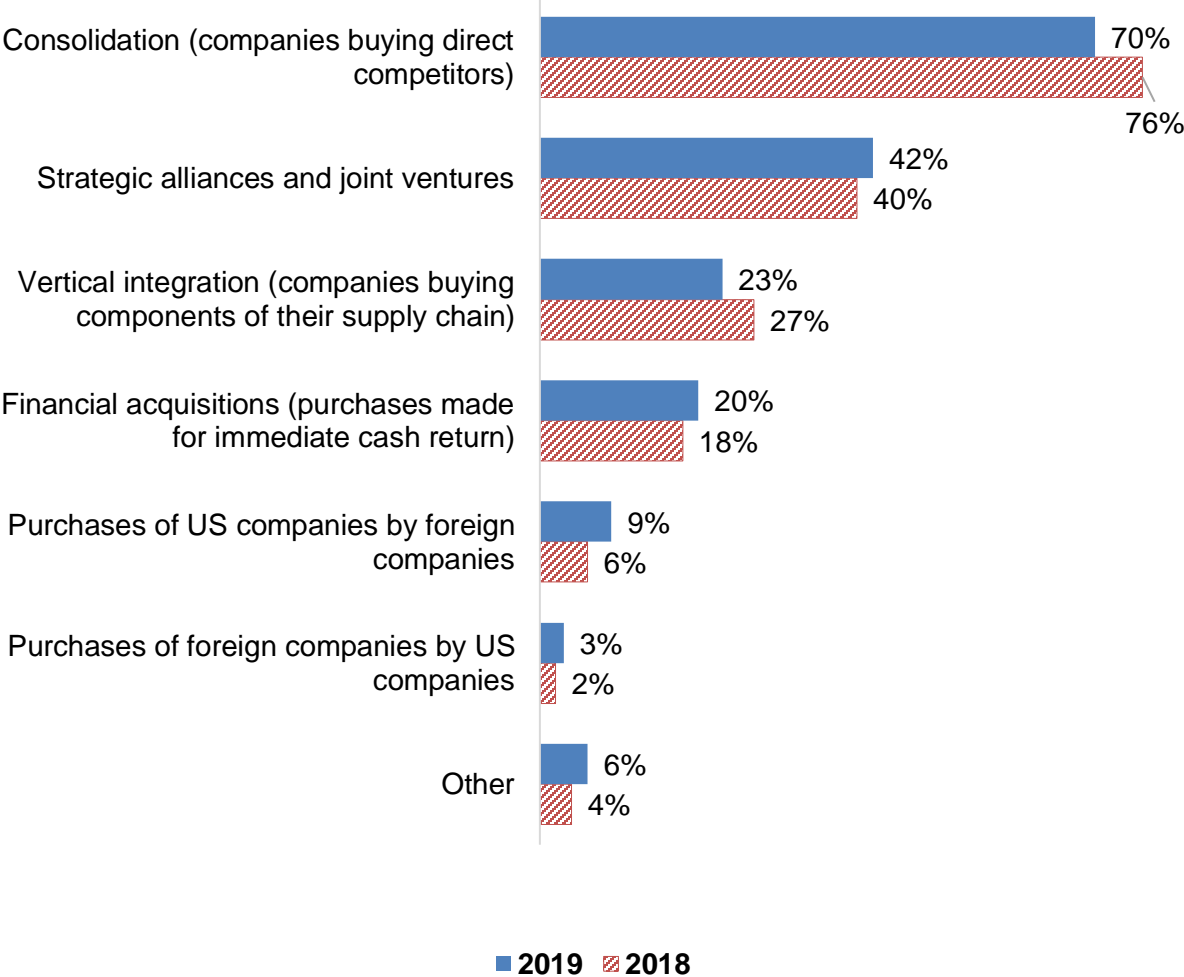


***Has your company engaged in any M&A or external growth activities in 2018?***



Consolidation was the most common form of M&A (70%) followed by strategic alliances and joint ventures (42%). Vertical integration came in third (23%) and financial acquisitions followed at fourth (20%). This matches closely with the top kinds of activity observed in 2018.

***In your industry, which kinds of M&A activity did you see most of in 2019?***



*Multiple responses allowed.*

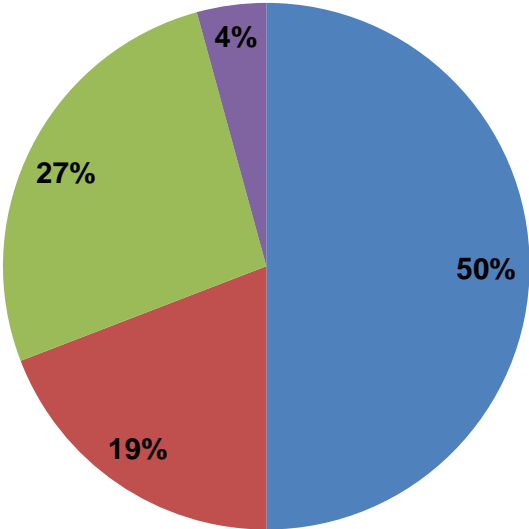
# M&A Motivations

Capstone uses a tool called the Opportunity Matrix which presents four growth options for organizations to consider. As expected, most of the survey respondents noted the least risky option, increasing sales of existing products to existing markets was most attractive (50%) and the fewest (4%) 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?

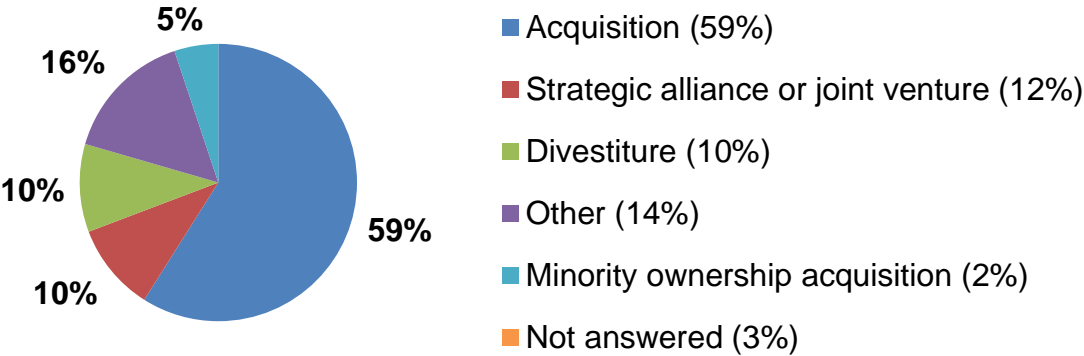


- Increase sales of current products to current market(s) (42%)
- Sell current products to new market(s) (30%)
- Create and sell new products to current market(s) (23%)
- Create and sell new products to new market(s) (4%)

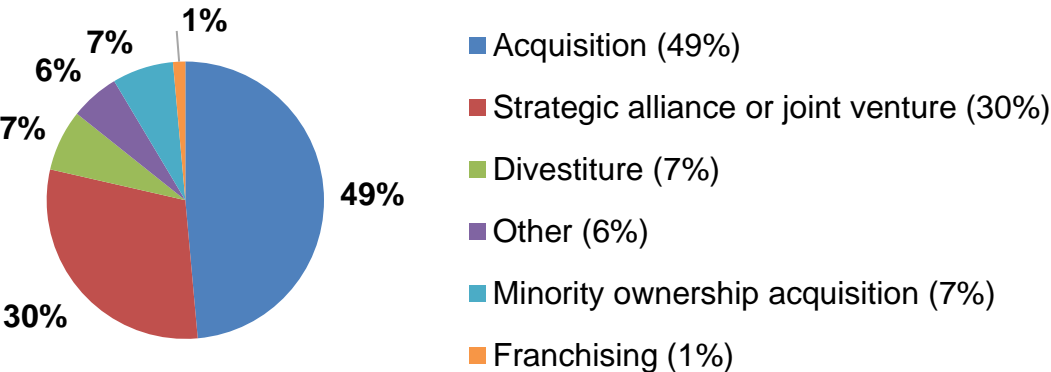
Acquisition remains the most popular form of external growth, at 59% in 2019 compared to 49% in 2018. There has been a downward shift in interest in strategic alliances and joint ventures with 12% in 2019 compared to 30% in 2018. Fewer were interested in divestiture (10%) and minority investment (2%).

Interestingly, multiple respondents who selected “other” noted that they had executed more than one deal in 2019 using various forms of external growth. There are many forms of external growth, aside from 100% acquisition, and although acquisition is the most popular tactic, companies are executing deals with various deal structures to achieve their growth goals.

**2019 responses**



**2018 responses**

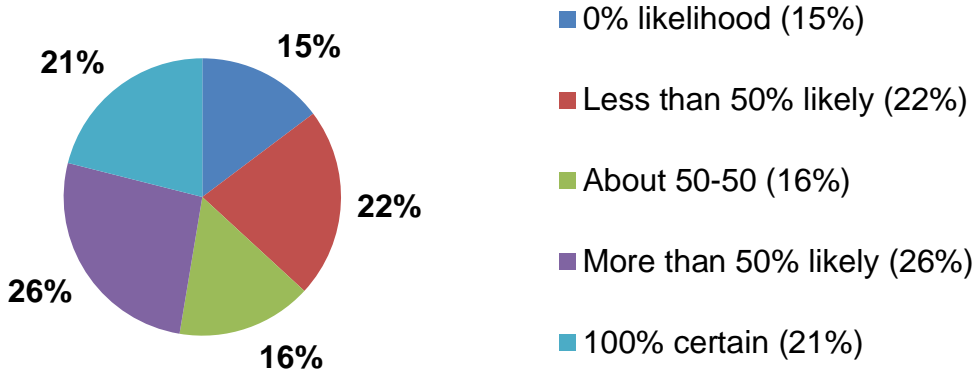


*Only includes answers from respondents who engaged in M&A in 2019*  
*Only includes answers from respondents who engaged in M&A in 2018*

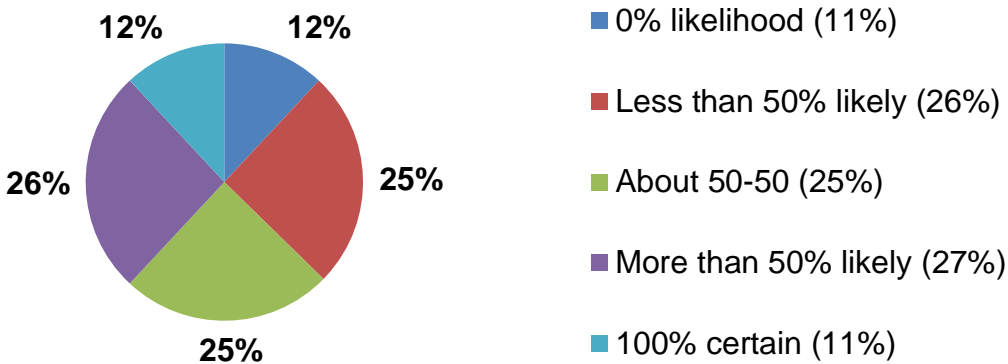
# Looking Forward to 2020

We are seeing a renewed interest in pursuing M&A in 2020. Compared to last year, a greater percentage of respondents are certain they will pursue M&A this year (21% compared to 11%) and a same number of respondents are more than 50% likely to do a deal (26% compared to 27%). Those with no interest in pursuing M&A dropped (16% to 13%). Those reporting a 0% likelihood of a transaction remained relatively flat (15% vs. 11%).

## How likely is it that your company will pursue some form of M&A or external growth in 2020?

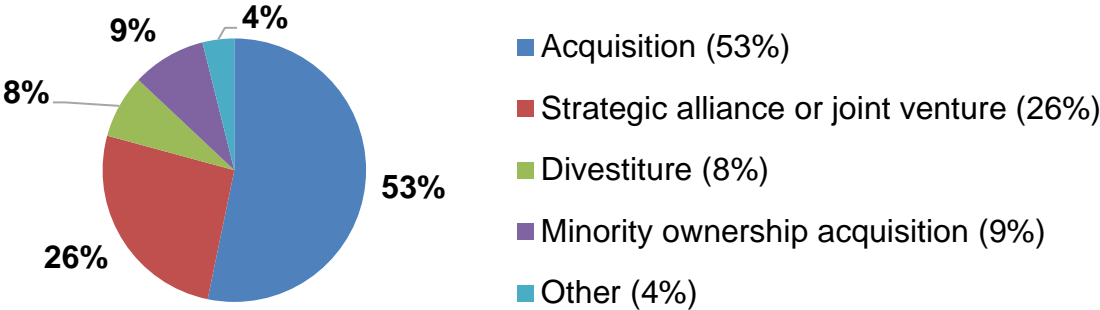


## How likely is it that your company will pursue some form of M&A or external growth in 2019? (Responses from last year's report)



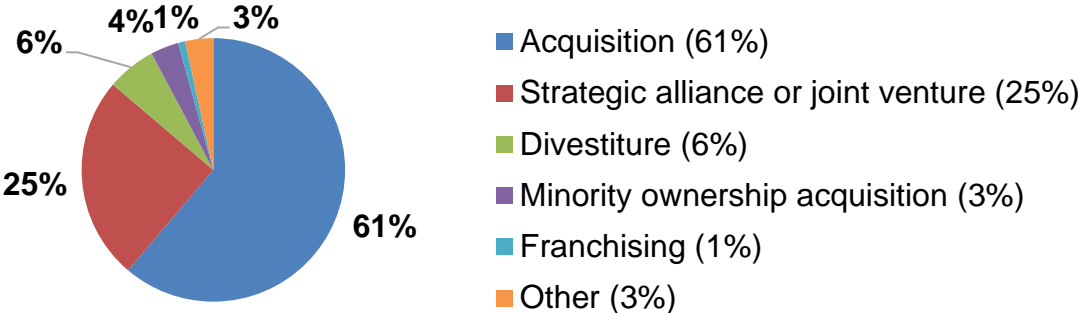
For those expecting to engage in M&A, acquisition continues to be the most popular form of external growth (53%) followed by strategic alliances or joint venture (26%). A small minority are interested in divestiture (8%) and minority ownership (9%) in 2020.

***If you expect your company to engage in M&A in 2020, which of the following is most likely?***



*Only includes responses of those who are interested in pursuing M&A in 2020*

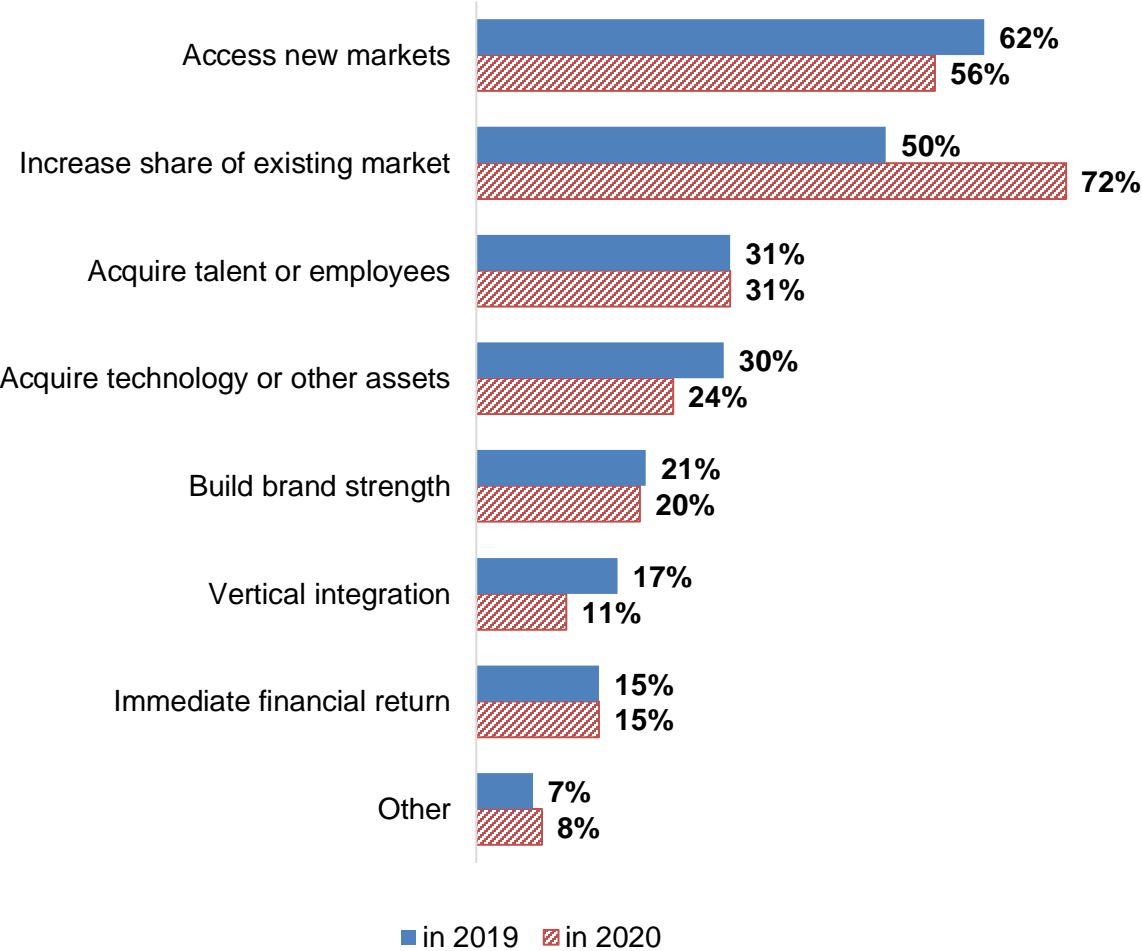
***If you expect your company to engage in M&A in 2019, which of the following is most likely? (Responses from last year’s report)***



*Only includes responses of those who are interested in pursuing M&A in 2019*

Accessing new markets (56%) and increasing share of existing markets (72%) are the most popular reasons for pursuing M&A and external growth in 2019. Talent (31%) and technology (24%) acquisition are also critical drivers for M&A. Just like the last survey in 2018, 15% noted immediate financial return as a rationale for external growth, suggesting respondents are focused on long-term growth and strategic transactions. Other interesting reasons provided by participants in the comments include exit non-performing markets, acquire new product supply, operational efficiencies and reduction in duplication of services.

***If your company is likely to engage in M&A or external growth in 2020, which of these is the most likely reason?***



*Multiple responses allowed*

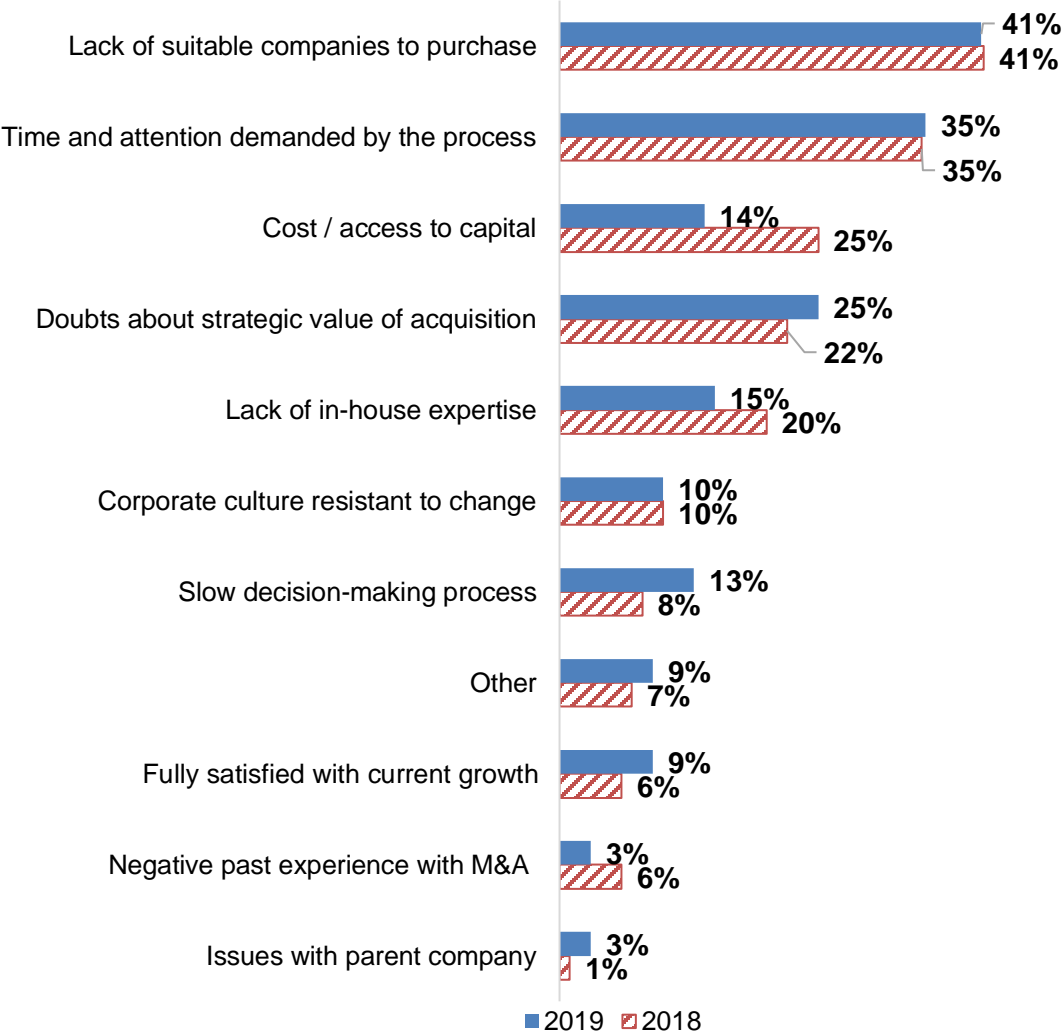


## **Barriers to M&A**

Participants struggled to find suitable acquisition prospects, with 40% citing this as the top barrier to M&A in 2019. Time and attention demanded by the process (35%), doubts about strategic value of a deal (25%), and lack of in-house expertise (15%) were also major challenges. These were the same top four barriers participants faced in last year's survey, although the rankings varied slightly as noted in the chart below.

Fortunately, there are a number of solutions to these obstacles including looking at not-for-sale acquisitions and developing strong acquisition criteria to broaden the scope of potential acquisition prospects. Most middle market companies and small businesses do not have dedicated corporate development teams so understandably finding the time to pursue strategic M&A can be a struggle. A trusted third-party M&A advisor can augment a company's capabilities, provide additional resources, tools, and expertise.

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



*Multiple responses allowed.*

## Conclusions

2019 was a modest year for growth and mergers and acquisitions activity. Even though the number of respondents who engaged in M&A in 2019 dropped (from 52% to 41%) when compared to 2018, most respondents were generally positive and reported growth in their industries. In addition to acquisitions, we saw a growing interest in strategic alliances and joint ventures.

It may be surprising to some, but cost is not the highest barrier to pursuing external growth. Time and attention demanded by the process (34%) and lack of suitable companies to purchase (40%) were the top 2 reasons for not considering external growth. For middle market companies, finding the right resources internally can be a challenge. Fortunately, companies can resolve this challenge by engaging with a third-party advisor who can provide expertise and resources for managing time and attention required to pursue growth through M&A.

Looking forward to 2020, we expect the deal levels to be down from the 2019 levels. Executives are still interested in pursuing forms of external growth and are in general positive, yet cautious about the environment for growth. Concerns about a recession and the impact of COVID-19 are certainly on the minds of some and will likely hamper M&A activity. To prepare for shifting business environment whether caused by changing economic conditions or industry players, middle market companies should consider proactively pursuing strategic deals to remain competitive and successful in the future.

## About Capstone

Capstone is a leading M&A advisory firm for the middle market focused on helping companies through strategic mergers and acquisitions. We have over 24 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).