

State of Middle Market M&A 2021

The Capstone Strategic Report

April 2021

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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 2021 report is our eighth in this series. Previous reports can be viewed on our [website](#).

Key Findings

1. **Growth was generally positive in 2020** with most respondents observing a positive growth picture in their industries. 59% respondents reported modest growth in 2020 as compared to 72% in 2019. 13% reported high growth in 2020, as compared to 10% in 2019.
2. **We have received a mixed response for the M&A activity in 2020.** 34% of the respondents reported less activity in 2020 compared to 2019 (16%). Whereas the number of respondents who reported more activity is stable with 36% in 2020 as compared to 35% in 2019.
3. 65% of respondents stated that COVID-19 had a medium effect on their business in 2020.
4. **The percentage of those who engaged in M&A or external growth activities in 2020 (43%) is similar to 2019 levels (41%).**
5. Acquisition remains the most popular form of external growth, at 61% in 2020 compared to 59% in 2019.
6. **Time and attention demanded by the process (30%)** and lack of suitable companies to purchase (28%) were the top 2 barriers to M&A faced by participants.
7. Of the 43% who pursued M&A in 2020, the majority executed acquisitions (61%).
8. The **top driver for pursuing M&A in 2021** is to access new markets (65%).
9. 41% of the respondents stated that they expect COVID-19 to have a medium effect on business growth in 2021.

M&A Activity Remains Modest

As anticipated in last year's State of the Middle Market M&A Report, COVID-19 did have a moderate impact on most industries. 65% of respondents stated that COVID-19 had a medium effect on their business in 2020. 59% respondents reported modest growth in 2020 as compared to 72% in 2019. However, the percentage of those who engaged in M&A or external growth activities in 2020 (43%) is similar to 2019 levels (41%).

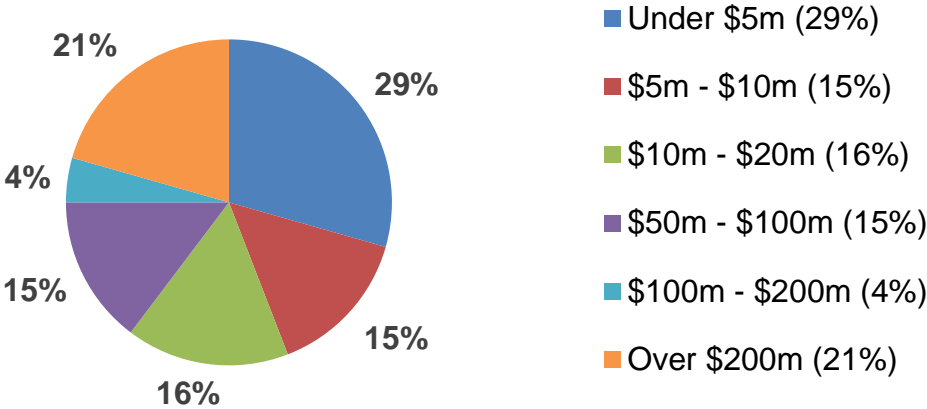
Given the responses from our survey participants and our own observations of the marketplace, we predict robust M&A activity for 2021. In February alone, deals totaling \$405.3 billion were announced globally, an increase of 45% compared with the same month last year. If 2020 was all about survival, 2021 is all about growth.

About the Survey

Capstone polled a sample of 68 business leaders in the middle market in a wide spread of industries. Businesses ranged in size from under \$5m to over \$200m in revenue. Our respondents were primarily CEOs and owners, along with other C-level executives. The survey was conducted in January and February 2021.

¹ Refinitiv – March 2021

What is the size of your company in revenue?



** Some industries have been consolidated for this report*

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 Manufacturing	Transportation / Logistics
Energy	Manufacturing	Water Treatment
Engineering	Marketing	Wholesale Distribution
Finance	Media	Wholesale Foods

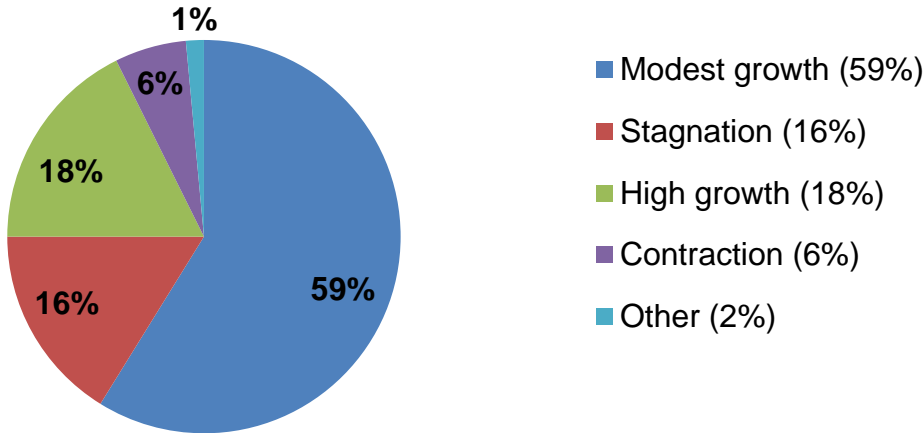
The Growth Picture

Growth was generally positive in 2020 with most respondents observing a positive growth picture in their industries. 59% of respondents reported modest growth in 2020 as compared to 72% in 2019. 13% reported high growth in 2020, as compared to 10% in 2019.

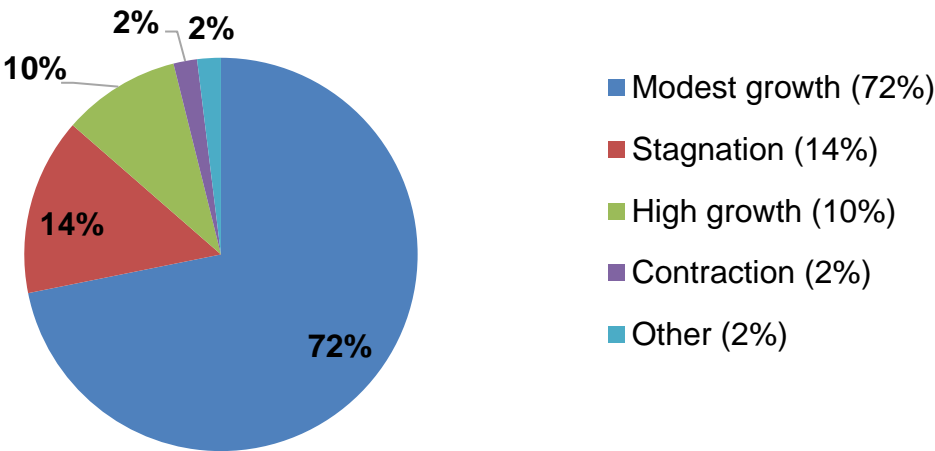
The percentage reporting contraction nearly tripled in 2020 (6% compared to 2%). Stagnation increased by 2% in 2020.

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

2020 responses



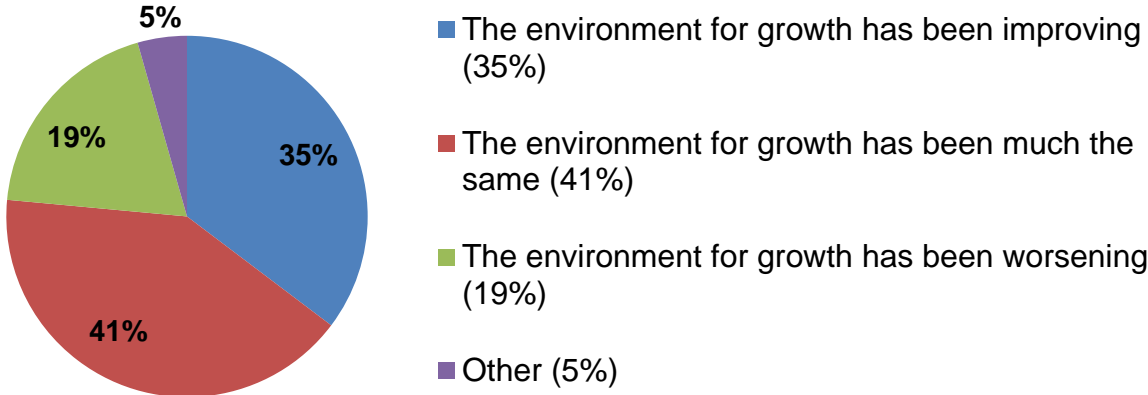
2019 responses



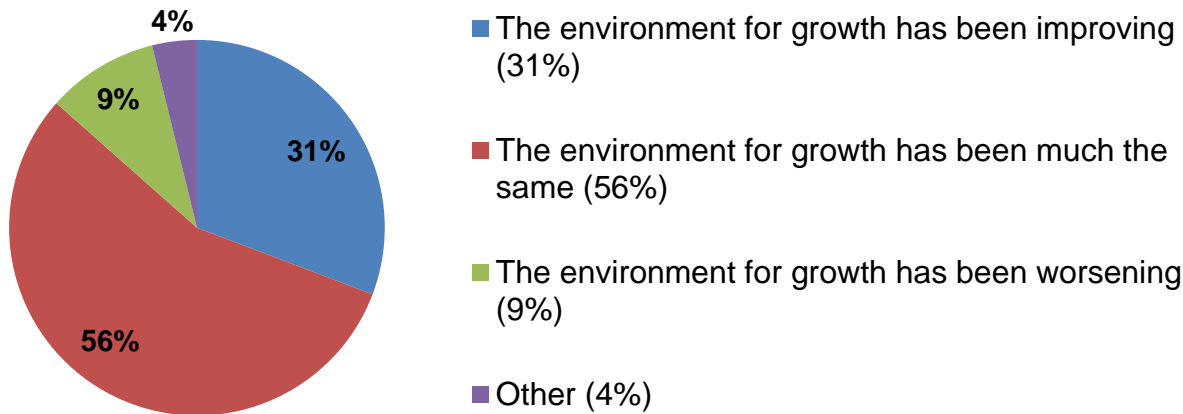
Responses may not add up to 100% due to rounding

The majority of respondents (41%) reported the environment for growth has been much the same in as it was in 2019. Meanwhile the percentage reporting an improving environment for growth remained relatively flat with 35% in 2020 vs 32% in 2019. The percentage reporting that environment for growth has been worsening has almost doubled (19% in 2020 vs.10% in 2019).

How would you describe the environment for growth in 2020?

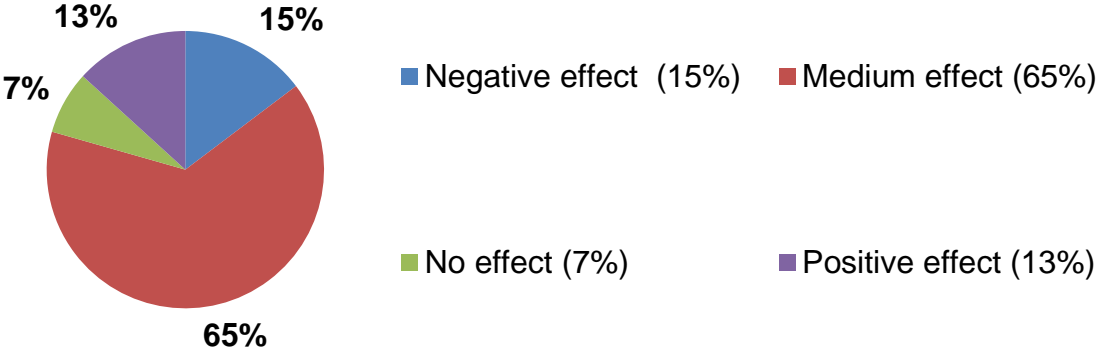


How would you describe the environment for growth in 2019?



Responses may not add up to 100% due to rounding

How has COVID-19 affected your business in 2020?

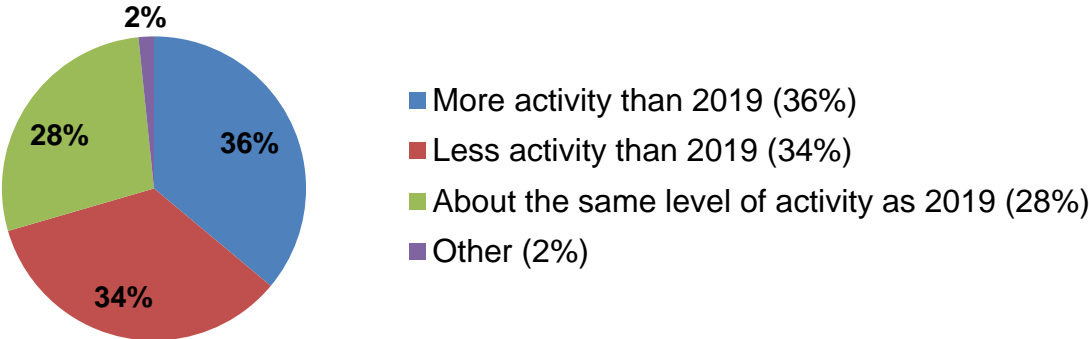


M&A Activity

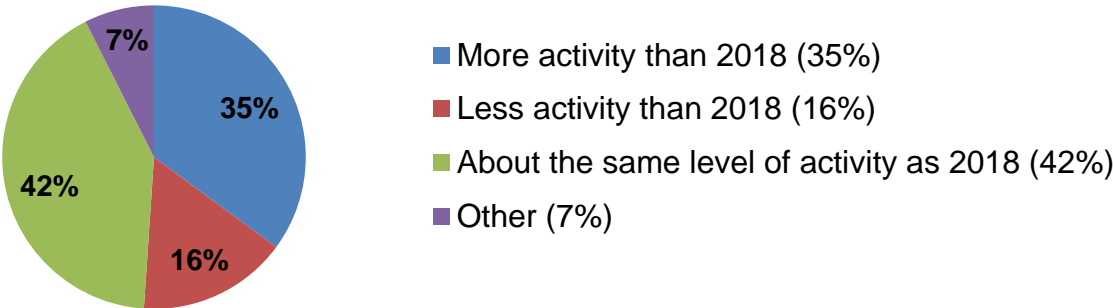
We have received a mixed response for M&A activity in 2020. 34% of the respondents reported less activity in 2020 compared to 2019 (16%). Whereas the number of respondents who reported more activity is stable with 36% in 2020 as compared to 35% in 2019. The survey data from the last five years suggests M&A activity 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 and then grew to 36% in 2020.

In your industry, how much M&A or external growth (acquisition, divestiture, joint venture, minority ownership, franchising) activity did you see in 2020?

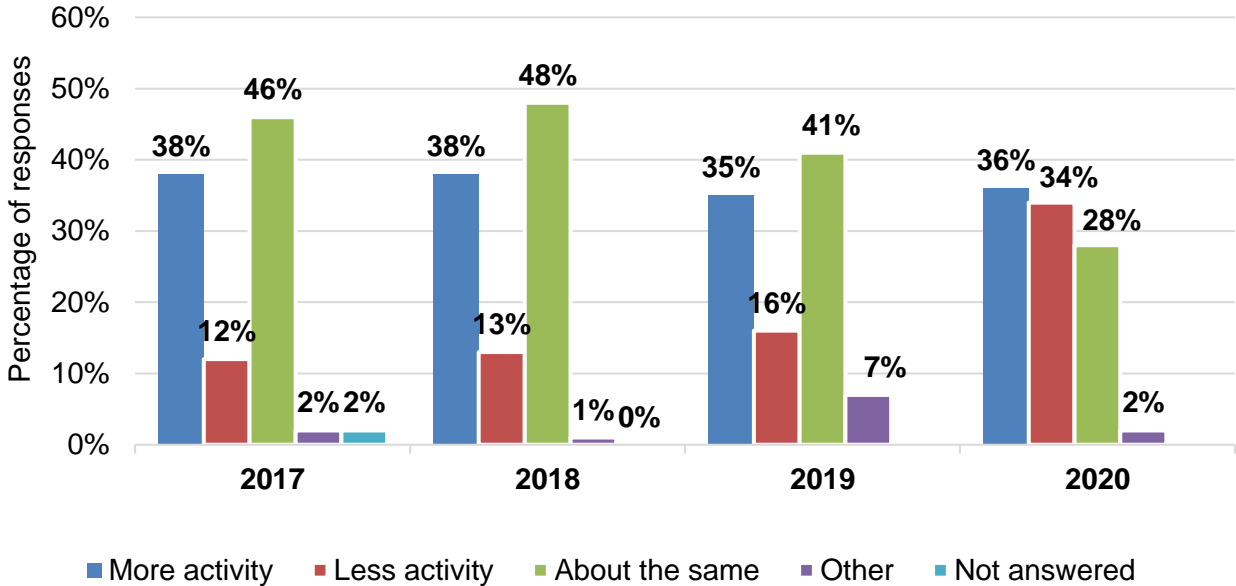
2020 responses



2019 responses



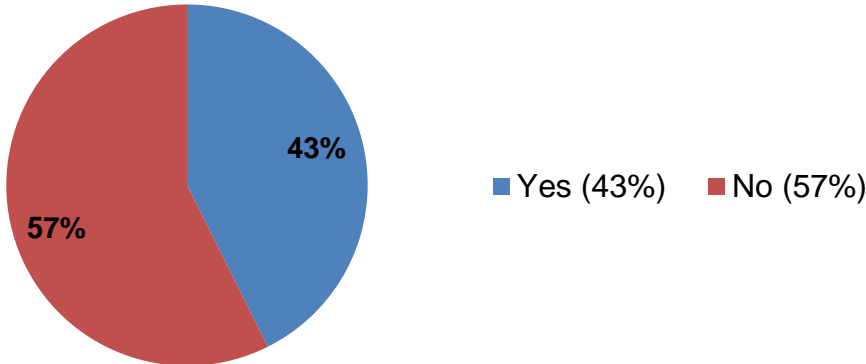
M&A Activity Reported by Year



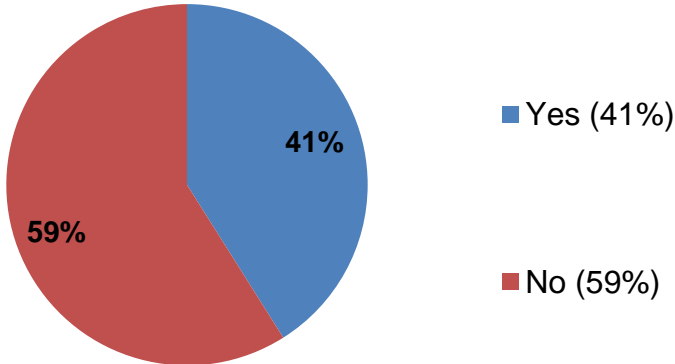
Responses may not add up to 100% due to rounding

The percentage of those who engaged in M&A or external growth activities in 2020 (43%) is similar to 2019 levels (41%).

Has your company engaged in any M&A or external growth activities in 2020?

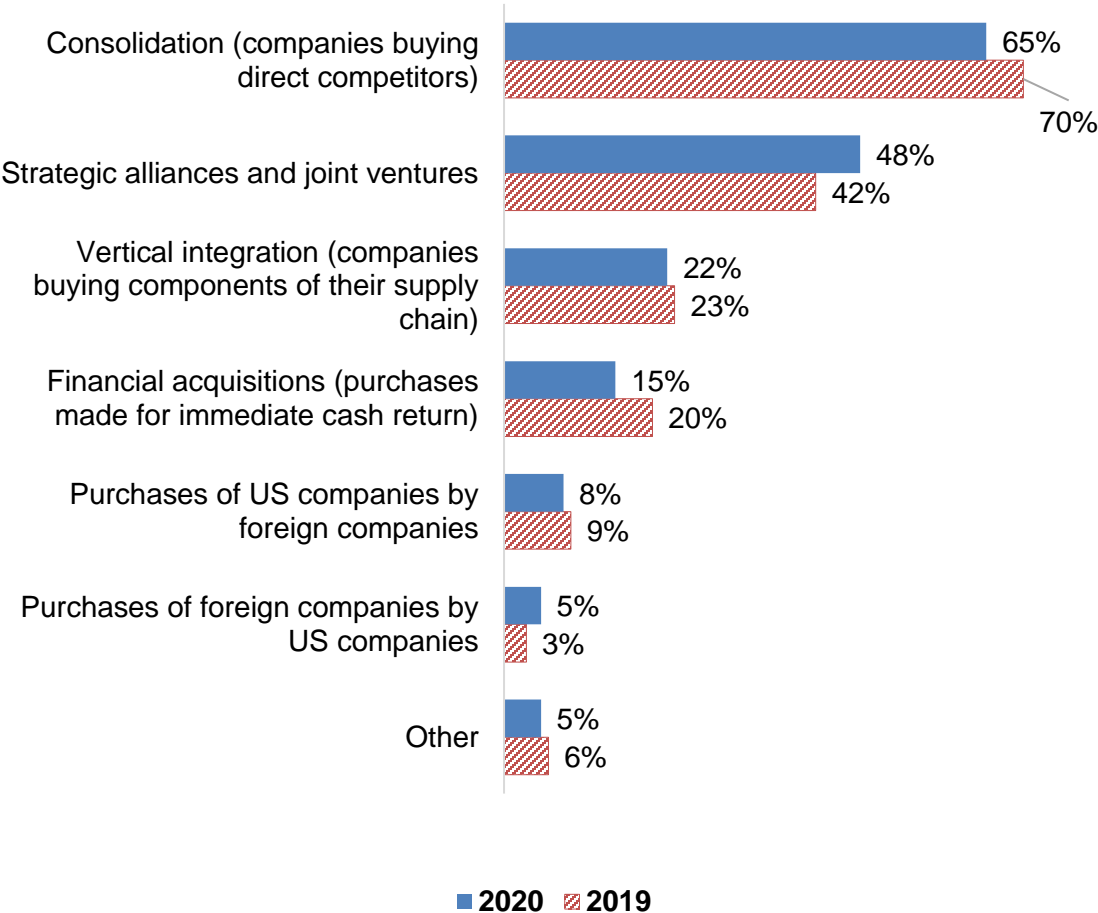


Has your company engaged in any M&A or external growth activities in 2019?



Consolidation was the most common form of M&A (65%) followed by strategic alliances and joint ventures (48%). Vertical integration came in third (22%) and financial acquisitions followed at fourth (15%). This matches closely with the top kinds of activity observed in 2019.

In your industry, which kinds of M&A activity did you see most of in 2020?



Multiple responses allowed.

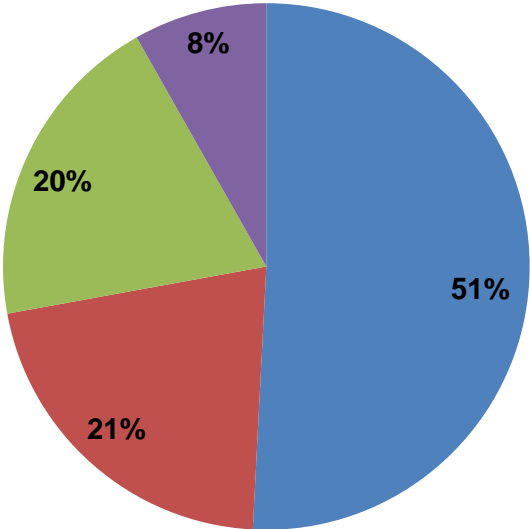
M&A Motivations

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 (51%) and the fewest (8%) were interested in selling new products to new markets, which is typically riskier. Although consolidation is the easiest and most natural to gravitate toward, companies should still consider the other opportunities.

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?

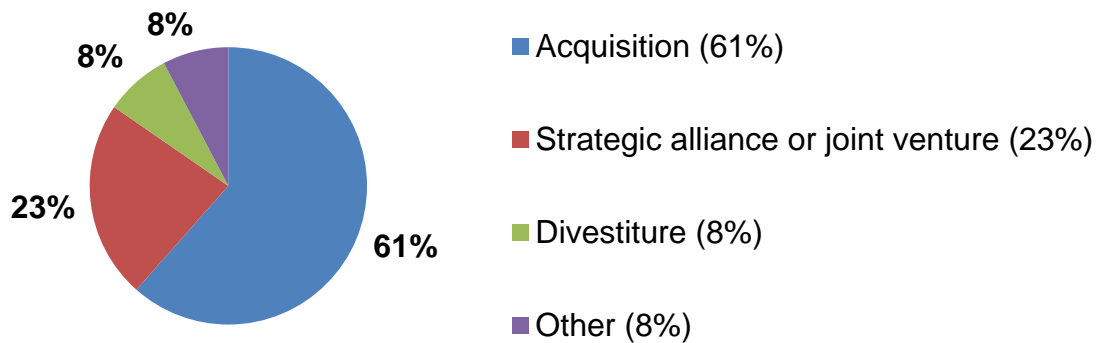


- Increase sales of current products to current market(s) (51%)
- Sell current products to new market(s) (21%)
- Create and sell new products to current market(s) (20%)
- Create and sell new products to new market(s) (8%)

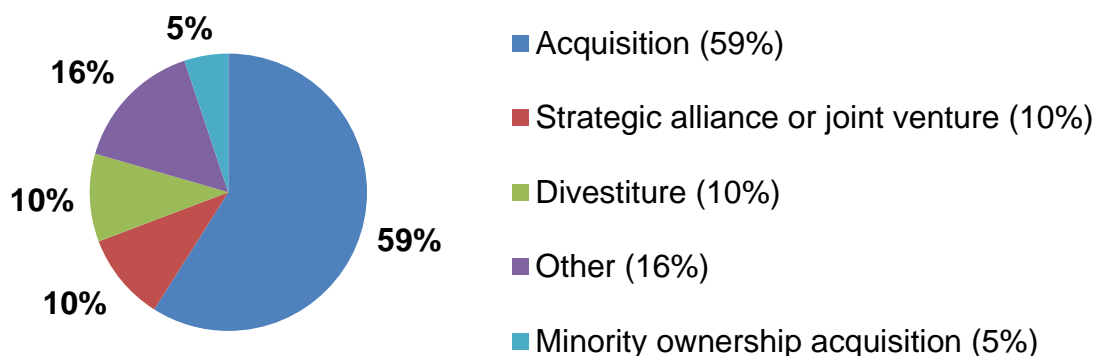
Acquisition remains the most popular form of external growth, at 61% in 2020 compared to 59% in 2019. There has been an upward shift in interest in strategic alliances and joint ventures with 23% in 2020 compared to 12% in 2019. Fewer were interested in divestiture (8%).

Interestingly, multiple respondents who selected “other” noted they had executed more than one deal in 2020 using various forms of external growth. One executive mentioned that acquisition, divestiture and strategic alliances were executed yearly by his organization. There are many forms of external growth, aside from 100% acquisition, and although acquisition is the most popular tactic, companies are executing multiple deals with various deal structures to achieve their growth goals.

2020 responses



2019 responses



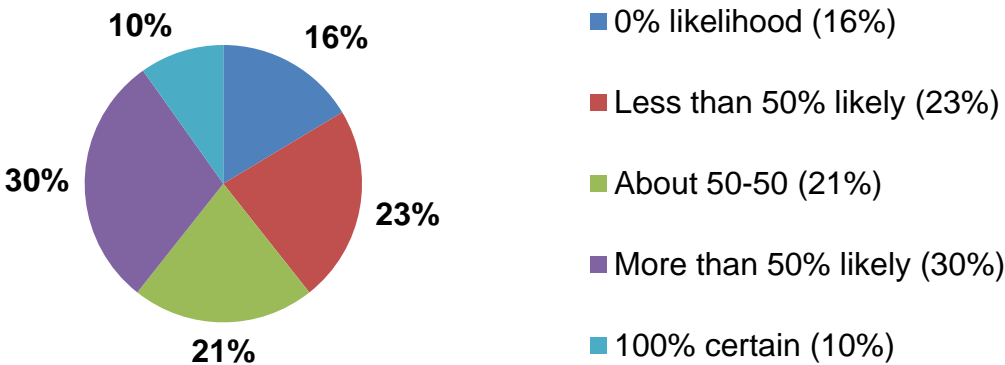
Only includes answers from respondents who engaged in M&A in 2020

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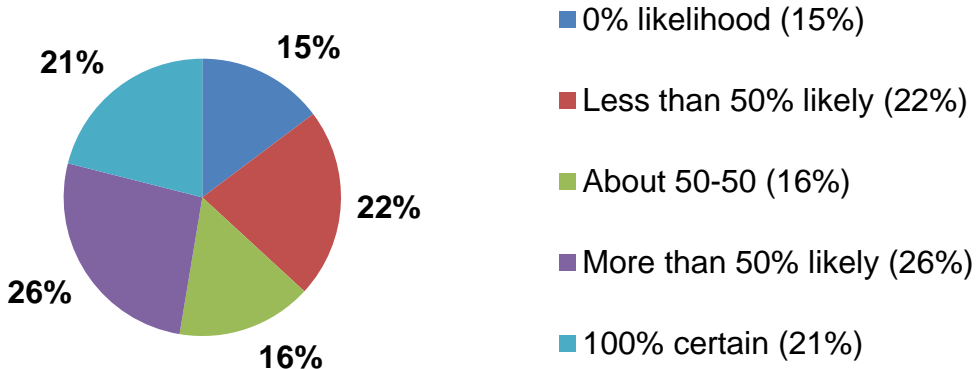
Looking Forward to 2021

When it comes to pursuing M&A and external growth in 2021, a lower percentage of participants are absolutely certain about deal making in the coming year. While fewer are 100% likely to pursue M&A in 2021 than in 2020 (10% vs. 21%), about the same are more than 50% likely (30% vs. 26%) to do a deal. Those reporting a 0% likelihood of a transaction remained relatively flat (16% vs. 15%).

How likely is it that your company will pursue some form of M&A or external growth in 2021?

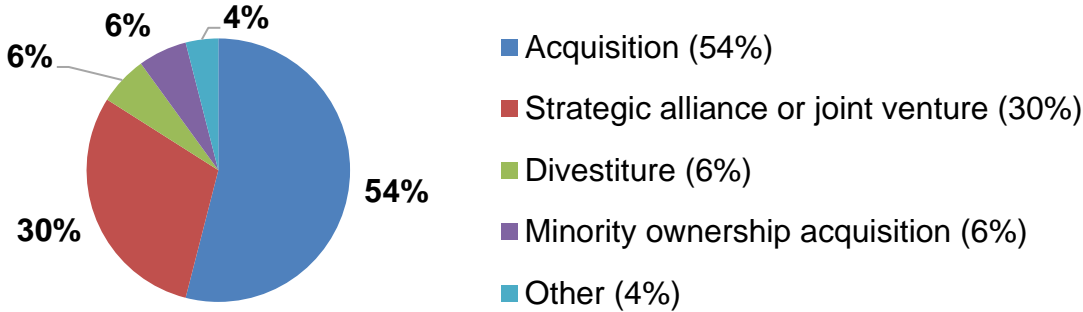


How likely is it that your company will pursue some form of M&A or external growth in 2020? (Responses from last year's report)



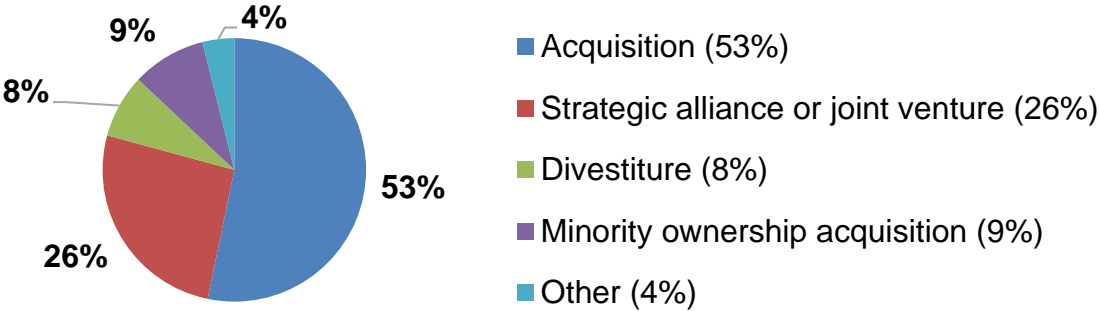
For those expecting to engage in M&A, acquisition continues to be the most popular form of external growth (54%) followed by strategic alliances or joint venture (30%). A small minority are interested in divestiture (6%) and minority ownership (6%) in 2021.

If you expect your company to engage in M&A in 2021, which of the following is most likely?



Only includes responses of those who are interested in pursuing M&A in 2021

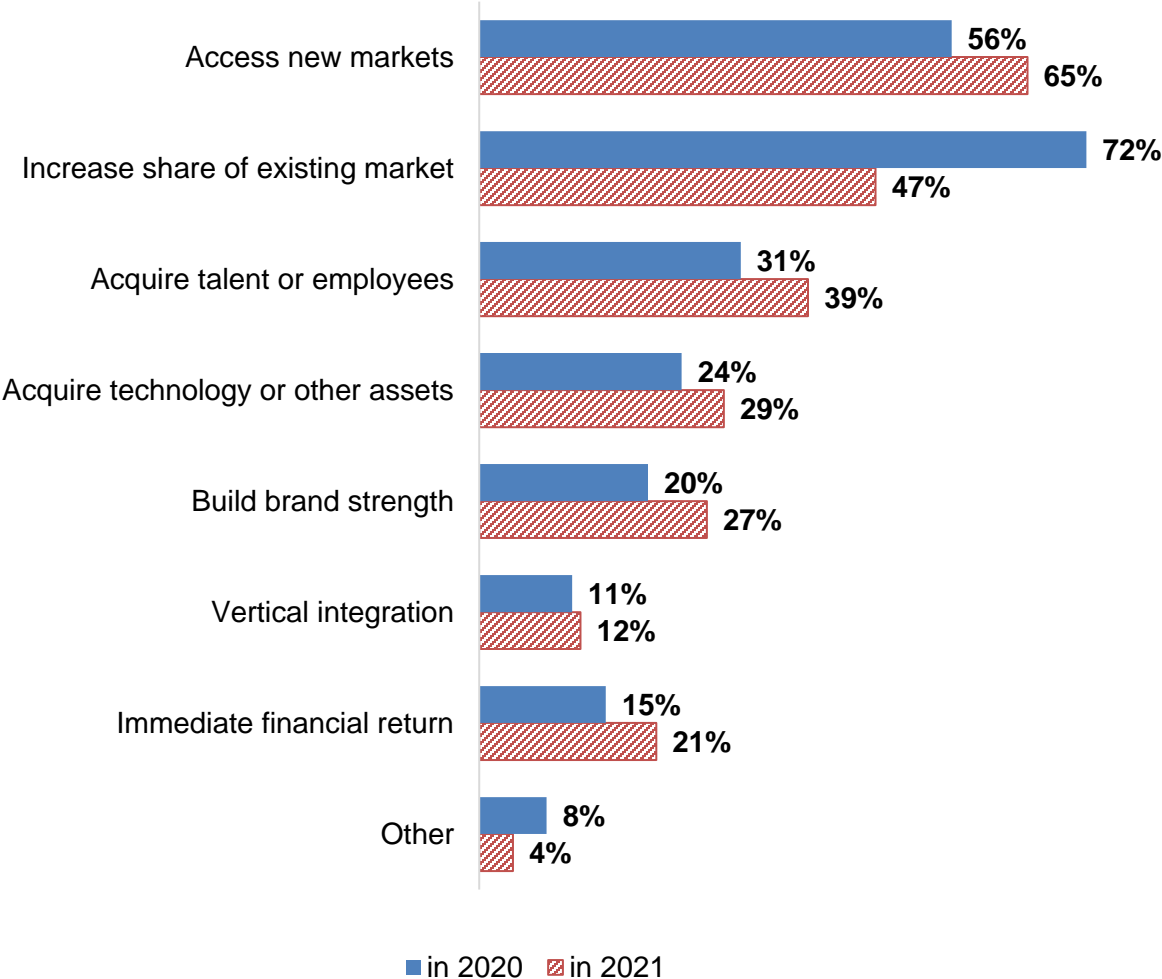
If you expect your company to engage in M&A in 2020, which of the following is most likely? (Responses from last year's report)



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

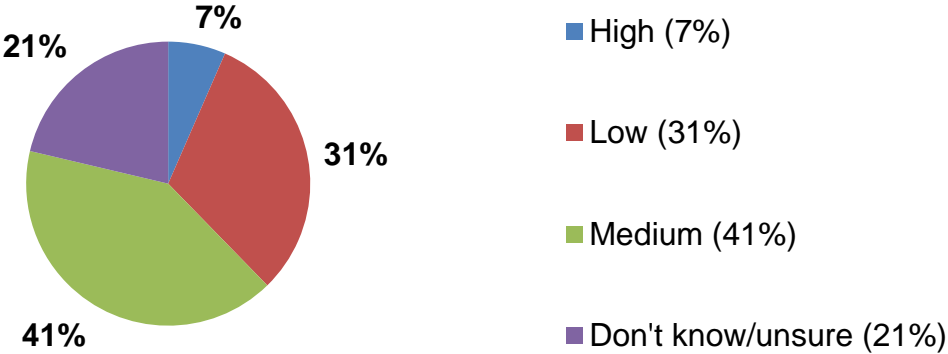
Accessing new markets (65%) and increasing share of existing markets (47%) are the most popular reasons for pursuing M&A and external growth in 2021. Talent (39%) and technology (29%) acquisition are also critical drivers for M&A. 21% noted immediate financial return as a rationale for external growth, suggesting respondents are focused on long-term growth and strategic transactions. Other interesting reasons provided by participants in the comments include protecting their existing share of market, 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 2021, which of these is the most likely reason?



Multiple responses allowed

What level of impact do you expect COVID-19 to have on your business growth in 2021?



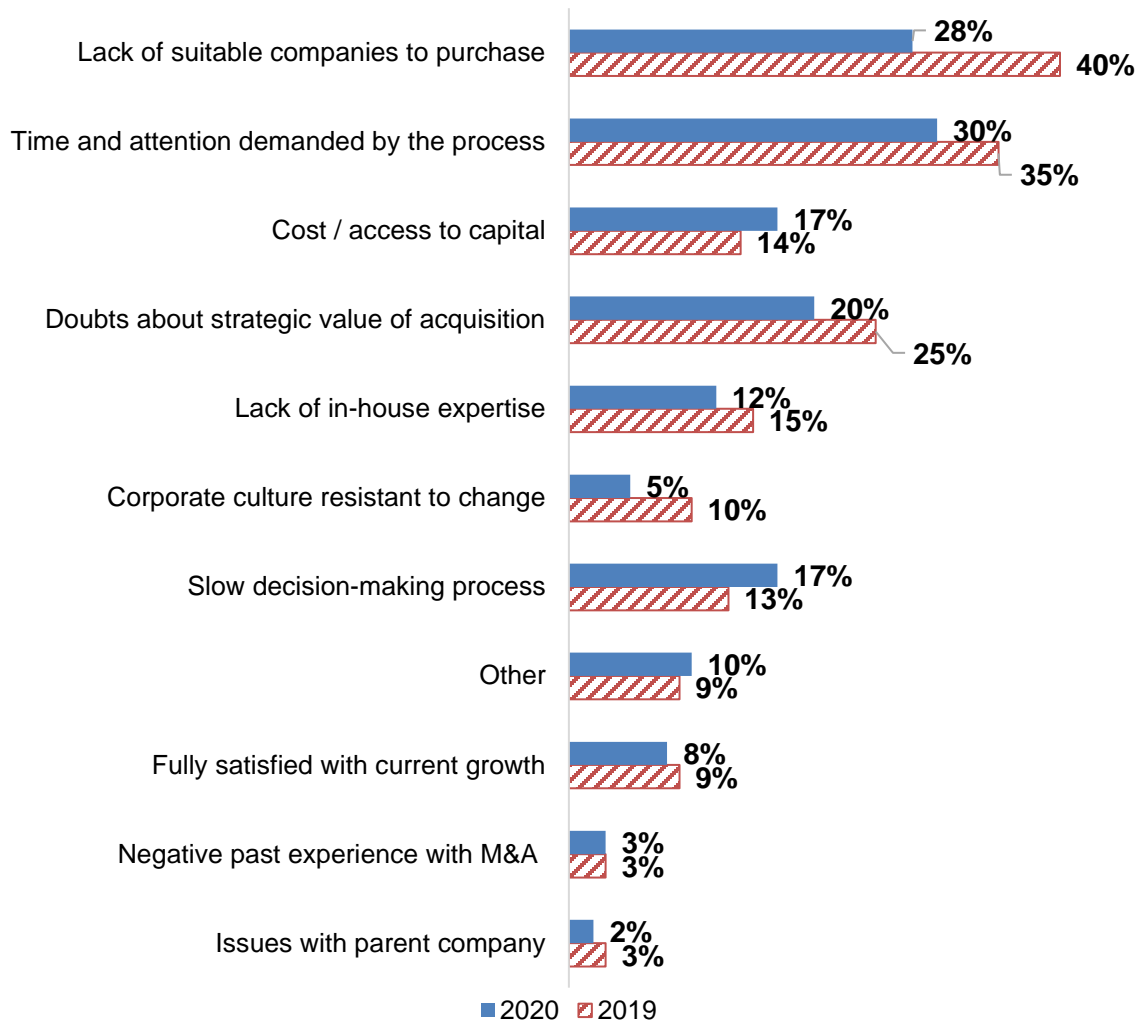
Barriers to M&A

Participants struggled to find time and attention demanded by the process, with 30% citing this as the top barrier to M&A in 2020. Lack of suitable companies to purchase (28%), doubts about strategic value of a deal (20%), slow decision-making process(17%) and lack of in-house expertise (12%) were also major challenges.

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. Fortunately, a trusted third-party M&A advisor can augment a company’s capabilities and provide additional resources, tools, and expertise.

Respondents may not find suitable acquisition targets because most tend to focus on for-sale deals. While there is nothing wrong with pursuing for-sale deals, this excludes many quality companies that may be suitable acquisition targets. Companies that are “not-for-sale” are simply not actively advertising selling, however, with the right offer from a strategic buyer, they may be willing to sell.

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



Multiple responses allowed.

Conclusions

After the uncertainty caused by the COVID-19 pandemic, the market began to settle, and businesses regained confidence towards the second half of 2020. Most of our survey respondents noted a modest environment for growth and were increasingly optimistic about future growth when compared to the previous year. Undoubtedly the strong performance of the stock market and the vaccine roll-out under the new administration of President Biden played a key role in boosting optimism.

2020 was a modest year for growth and mergers and acquisitions activity. 59% of respondents reported modest growth in 2020 as compared to 72% However, the percentage of those who engaged in M&A or external growth activities in 2020 (43%) is similar to 2019 levels (41%). 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 in addition to outright acquisitions as company leaders embraced creative deal structures to achieve their growth goals.

It may be surprising to some, but cost is not the highest barrier to pursuing external growth. The time and attention demanded by the process is the strongest reason respondents did not consider external growth. For middle market companies, finding the right resources internally can be a challenge.

Looking forward to 2021, M&A activity will be strong. Strategic acquirers still have an advantage over financial buyers when it comes to acquiring privately-held companies. In addition to financial consideration, shared vision, strategic fit, and company culture remain critical factors for sellers. As we move into 2021, all of these dynamics will contribute to a robust mergers and acquisitions pipeline for both financial and strategic acquirers.

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 26 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.