Citizens Capital Markets®

M&A OUTLOOK 2020

January, 2020

Outlook Still Favors Sellers, but Urgency Recedes as Growth Continues

Business leaders anticipate another relatively strong year for M&A in 2020, particularly for sellers with standout businesses. Interestingly, this year's survey also revealed little expectation of a near-term economic pullback and thus a lessened urgency to transact. Respondents characterize the M&A environment heading into 2020 as presenting fewer looming risks. They see companies relying more on organic growth, fewer sellers in the queue, and continued discipline among buyers. Mid-market leaders expect lower deal volumes, more strategic carve-outs and bolt-ons, and stable-to-higher valuations.

Outlook Still Favors Sellers, Urgency Recedes as Growth Continues

After a wobbly finish to 2018, 2019 turned out to be another strong year for M&A activity in the U.S. Mid-market leaders are expecting more of the same in 2020, according to the responses of our recent survey of nearly 600 executives.

The prevailing sense is that the backdrop is favorable, but the urgency to get deals done has ticked downward. In this environment, we see a picture where mid-market leaders are approaching M&A with measure and restraint.

We saw nuances in this year's outlook, which suggest that the year ahead could be one of comparative restraint for M&A deals. There appear to be signs of diminished urgency, resulting from a convergence of factors:

- ✓ The outlook for the **domestic economy is sturdy** and **worries have decreased**
- ✓ **Organic growth** prospects have improved, lowering the need to acquire growth
- ✓ Sellers are **less bullish about valuations** and **less confident about getting deals done**. These metrics could reflect the "reality checks" that some faced in 2019 deals, which were more balanced between buyer and seller terms than prominent deal headlines may have implied
- ✓ The **pool of sellers is smaller**, further indicating less of a sellers' market than it may appear on the surface
- ✓ Sellers and buyers appear to be more focused on **carve-outs** and **bolt-ons**, respectively, compared to complete sales

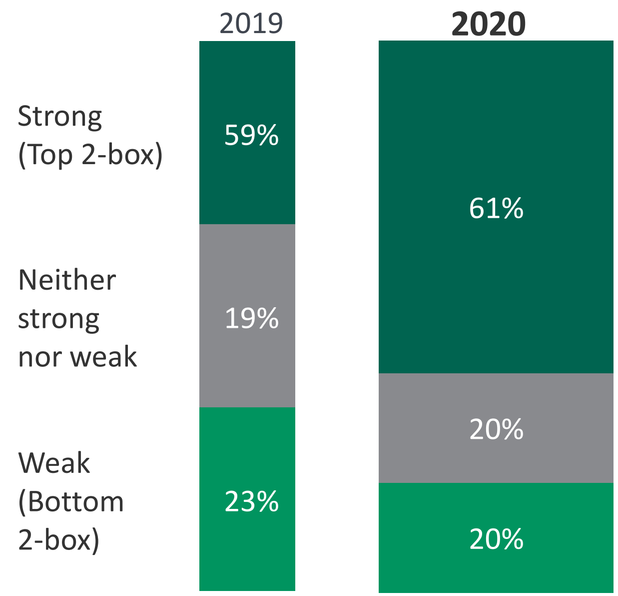
Companies say: Expecting continued strength in M&A in 2020

In 2020, mid-market leaders are expecting a strong M&A market. In fact, the overall profile is even brighter, in some respects, than a year ago.

A majority of survey respondents, 61%, said they anticipate a strong M&A environment, with only two in 10 saying they expect conditions to weaken.

They see a wide range of supportive factors driving this trend, led by the U.S. economic growth rate. A full 77% of respondents said the expanding domestic economy makes them more likely to pursue M&A in the year ahead. Tax policy changes, global economic conditions, and accommodative capital markets were also top-cited factors making mid-market leaders more likely to pursue M&A in 2020.

Strength of current M&A environment



Mid-market leaders' expectations even more upbeat than year-ago

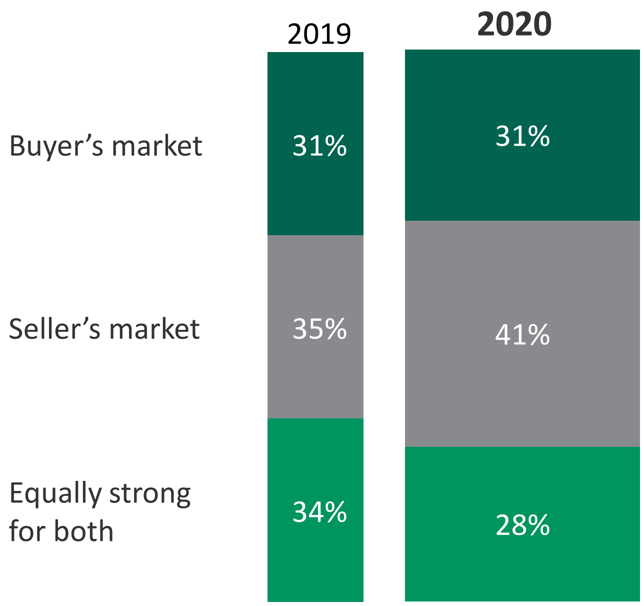
Sellers’ market continues

Mid-market leaders are expecting 2020 to be a sellers’ market, with 41% seeing the scales tipping in favor of sellers, up from 35% in the 2019 outlook. The expectations for a buyers’ market remained steady, while fewer respondents expect a balanced marketplace.

From Citizens M&A advisors:

“In 2019, a handful of prominent deals presented record-high valuations and were clear outliers compared to the median deal profile this past year. These headlines can contribute to a perception that the whole M&A market is biased heavily in favor of sellers. However, that impression may not be accurate. We saw a strong market in 2019, but it was more balanced between buyers and sellers than a few headline-grabbing deals may have suggested.”

Current M&A Market Type



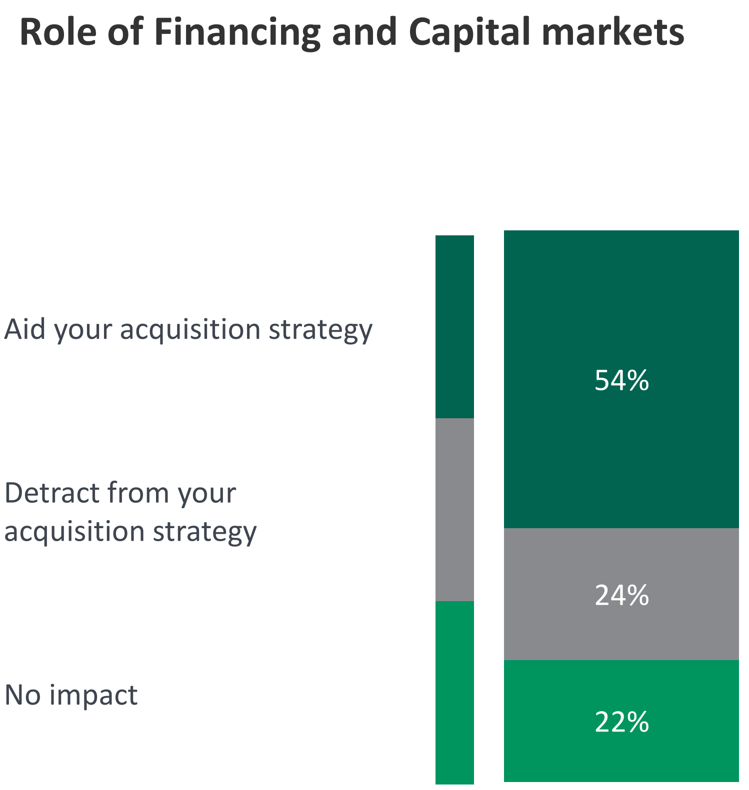
High-profile multiples contributing to view of sellers’ market?

Financing outlook is rosy

Buyers do not expect capital markets to be a roadblock to their aspirations. More than half say that the financing environment will help their acquisition strategy; while another quarter say it will have a neutral impact. Only 24% think that the capital markets could detract from their acquisition strategy.

From Citizens M&A advisors:

"The financing backdrop has definitely facilitated the M&A market through 2019, and we see more of the same for the year ahead, especially with historically low interest rates. However, one exception is prompting more scrutiny from lenders: businesses with higher cyclical exposure. We expect to see more intense lending diligence for these businesses going into 2020."



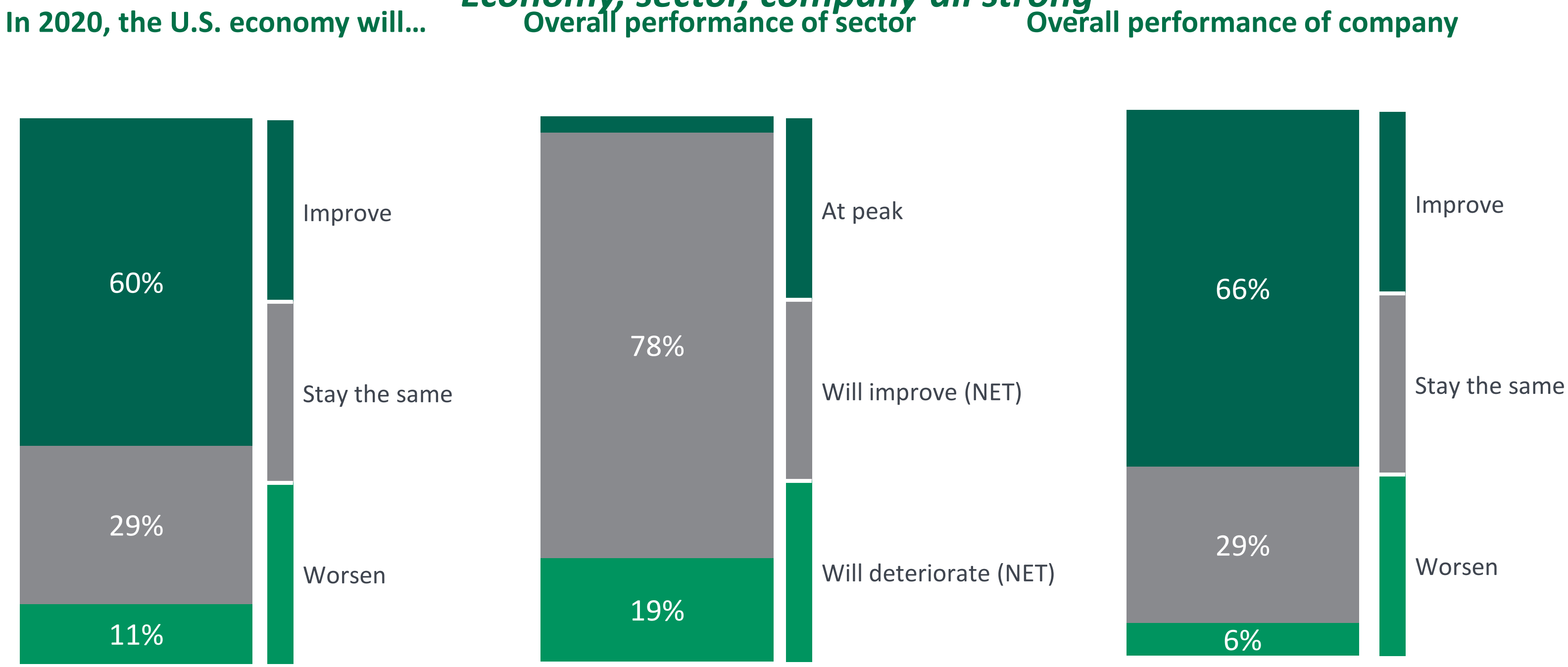
The majority see the current financing environment as supportive

Economic strength expected

The popular press may talk frequently of an impending economic slowdown, but mid-market leaders do not appear to share this expectation. In fact, survey respondents demonstrate heightened confidence in the trajectory of the economy, as well as that of their sector and their company.

Given these expectations, it’s no surprise that companies expect to continue hiring workers in the year ahead. 43% of mid-market leaders said they expect to hire at the same level as previous years, while a third of respondents said they expect to hire more employees than in the past few years. Only 1 in 5 said they expect to hire fewer people.

Economy, sector, company all strong

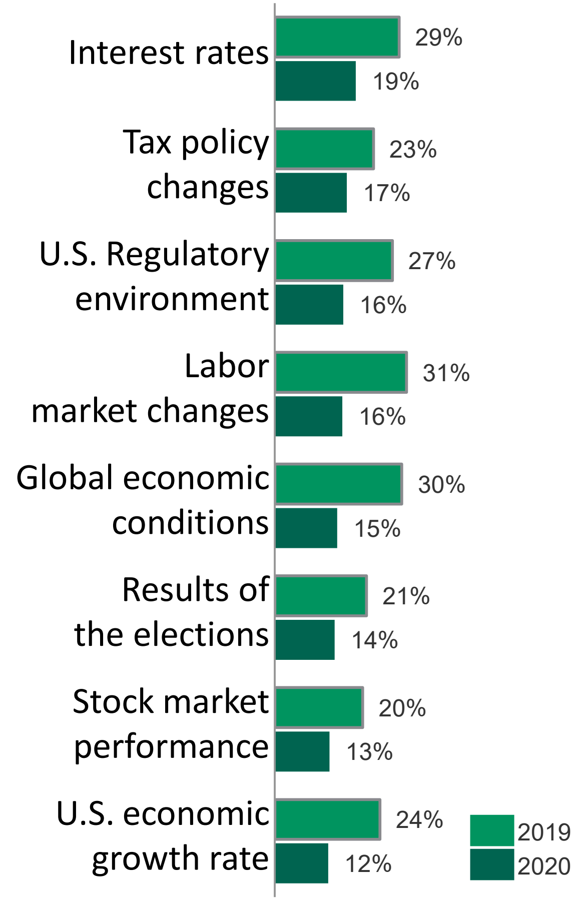


Despite headlines, worries have eased

Another sign of the broad-based confidence among mid-market leaders: they have fewer worries.

In fact, only 15% believe global economic conditions could or will negatively impact business operations, compared to 30% in the prior year's survey. We saw similar decreases across the list of operational risks, including interest rates, trade agreements, labor markets, and elections.

As they look ahead, no single risk appeared to be the primary concern of business leaders. The top-cited headwinds for 2020 were interest rates and tax policy changes, but those issues registered only a few percentage points more than other risks.



Mid-market executives unfazed by trade agreements and other risks

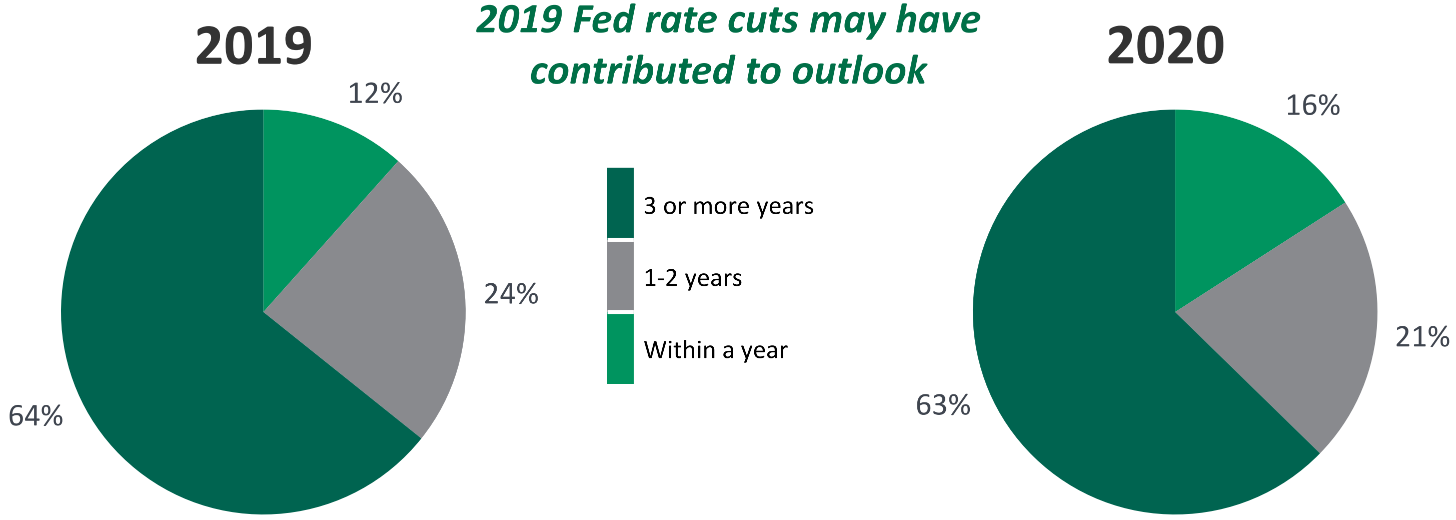
Fed moves bought more time?

The Federal Reserve's trio of interest rate cuts in 2019 may have bought more time for the M&A marketplace.

At the end of 2018, 64% of mid-market leaders said the M&A environment was likely to remain strong for three years or more. At the time, the Federal Reserve had just made an unpopular interest rate hike just as global growth appeared to be skidding to a halt and the U.S.-China trade war escalated.

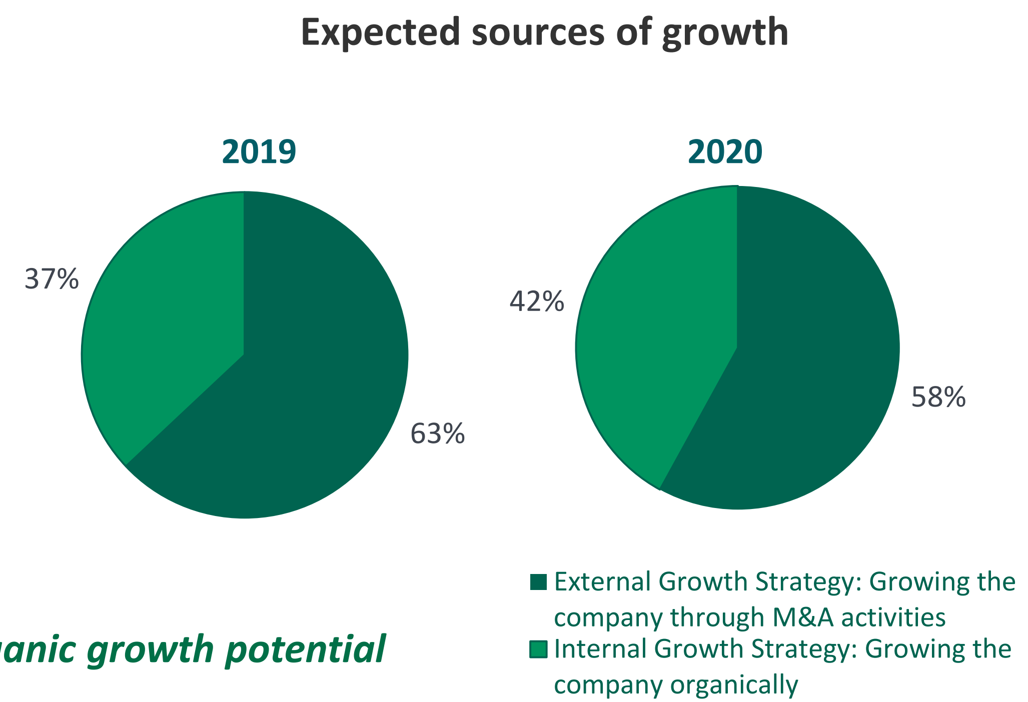
Fast-forward to the end of 2019, where the trade outlook has improved, the domestic economy appears more stable, and the Fed is once again accommodative. From this position, the outlook for the M&A market among respondents remains nearly identical, with 63% of mid-market leaders expecting this bull run to last for at least another three years.

2019 Fed rate cuts may have contributed to outlook



Organic growth opportunities tick upward

With a more solid economic outlook, businesses are relying more heavily on organic growth as opposed to acquisitions. 42% of mid-market leaders expect growth to come from internal strategies, compared to only 37% in the year before.

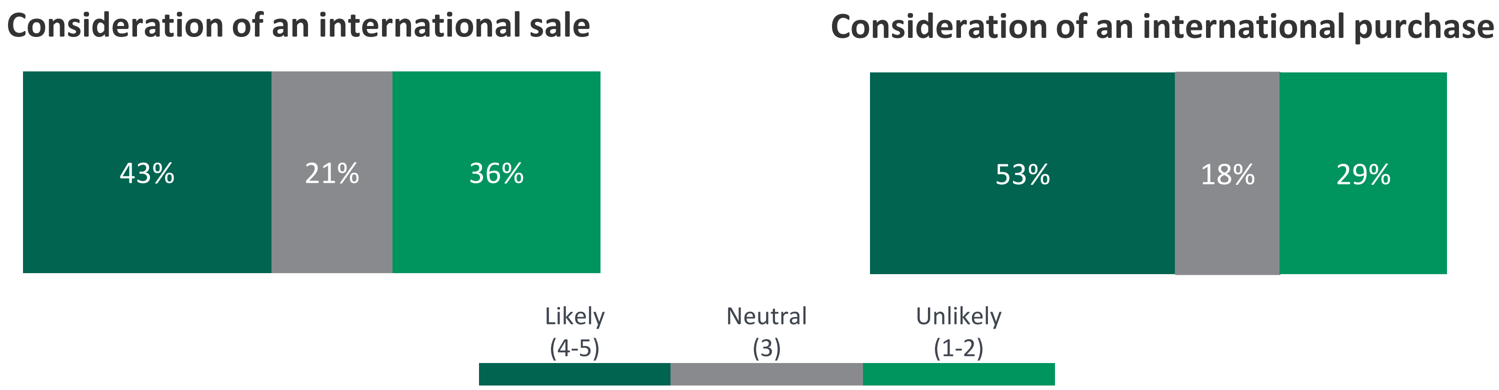


More mid-market businesses see organic growth potential

Fewer firms looking abroad to buy & sell

As prospects for organic growth brighten, fewer companies are looking abroad for M&A opportunities. In 2020, 43% of sellers said they would consider an international sale, compared to 52% in the prior year's survey. 53% of buyers said they would consider an international purchase, compared to 58% the year before.

Less drive for growth, diminished exchange-rate opportunity

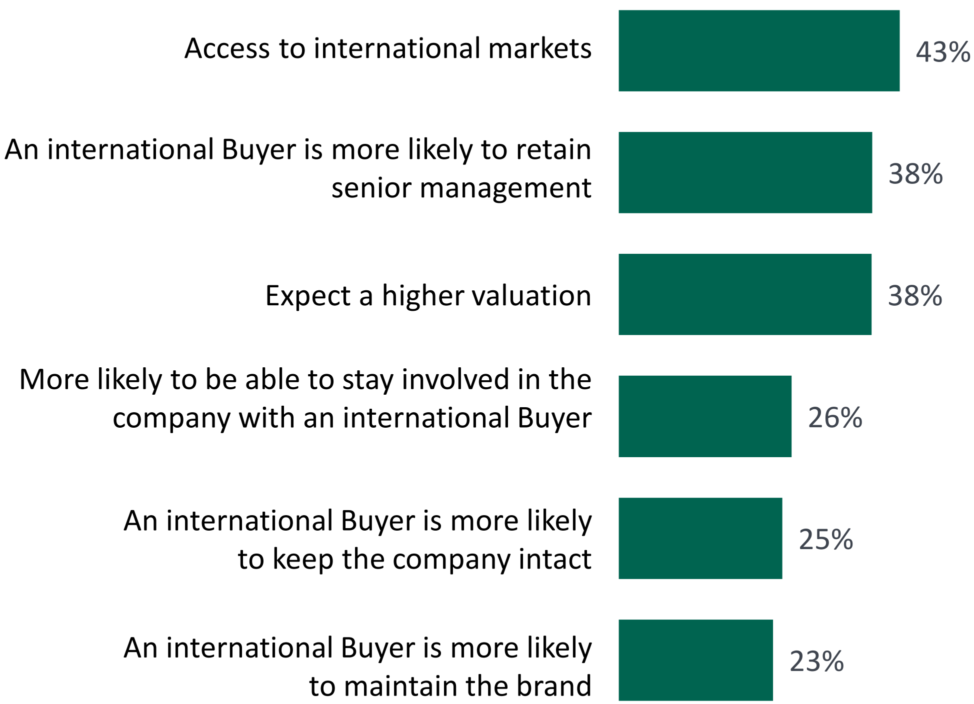


Fewer firms looking abroad to buy & sell

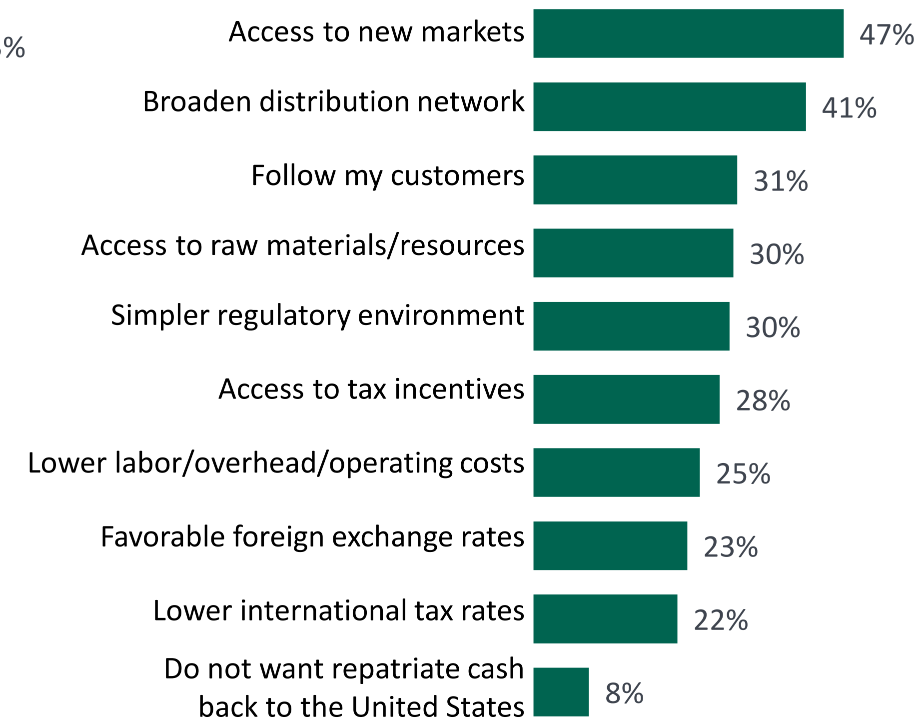
The exchange rate could be another factor dampening interest in international deals, as the U.S. dollar continued to be strong against peers. Domestic growth trends remained comparatively more robust than global trends.

Less drive for growth, diminished exchange-rate opportunity

Reasons for international sale



Reasons for international purchase



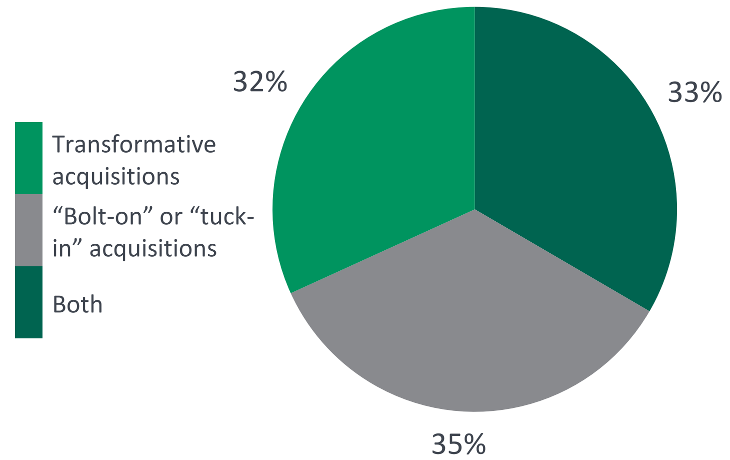
Fewer firms looking buy/sell entire business

Another indicator that organic growth is more promising: fewer participants are looking to sell their entire business. Heading into 2020, 27% of sellers have expressed interest in selling their entire business, down considerably from 47% the year prior.

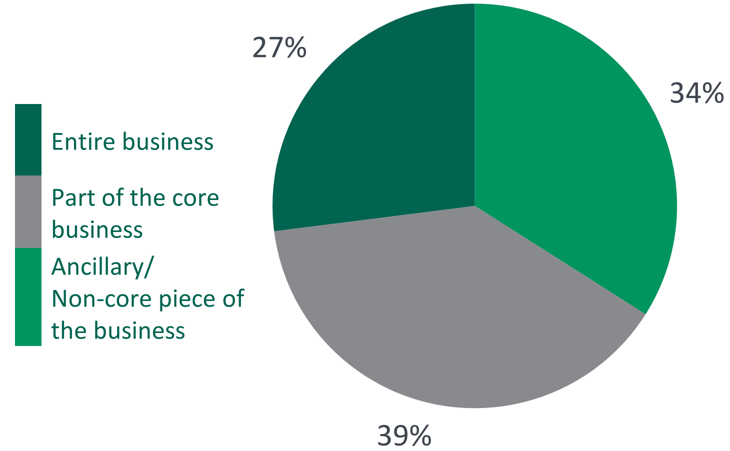
Likewise, buyers have less interest in transformative acquisitions, though the trend was less pronounced. 32% of mid-market leaders indicated interest in a transformative acquisition for 2020, compared to 35% the prior year.

More interest in carve-outs and bolt-ons

Scope of purchase



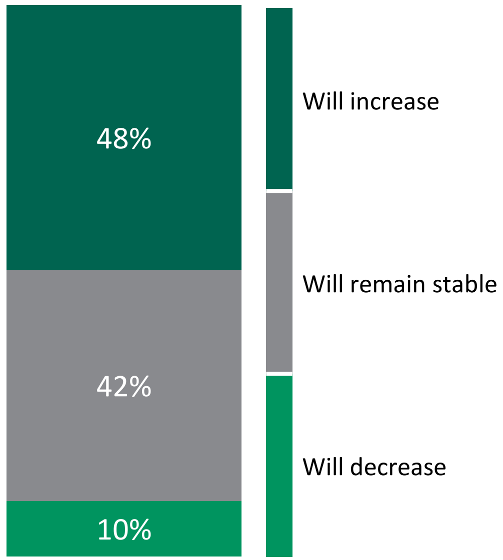
Scope of sale



Both buyers & sellers expect continued valuation strength

Valuations continued to be strong through 2019, and mid-market leaders are expecting more of the same for 2020. Only 10% of respondents anticipate valuations decreasing in the year ahead, while nearly half expect valuations to climb. These numbers are largely in-line with responses from the year before.

2020 Company valuations



Only 10% see valuations decreasing in 2020

Sellers are actually less bullish about valuations

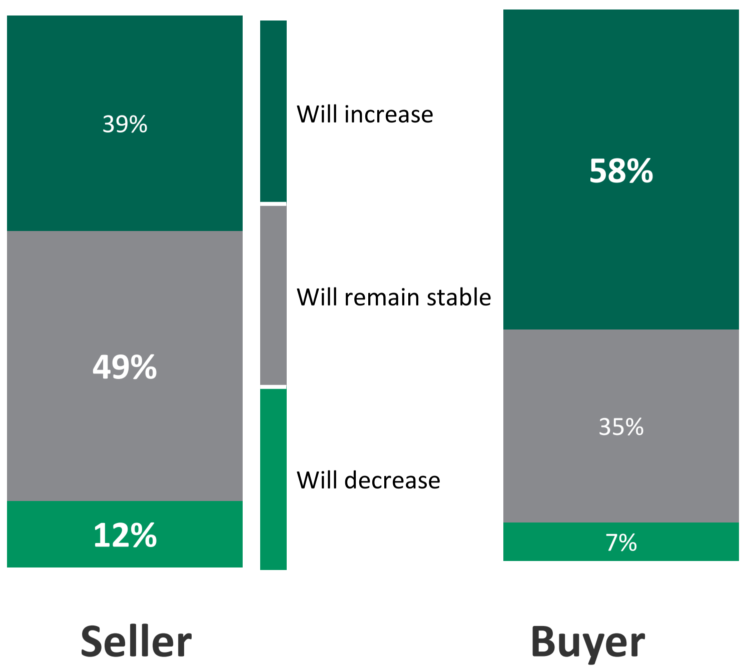
Though the valuation outlook is generally strong, we did observe a notable gap between the expectations of buyers and sellers.

Nearly half of sellers actually expect valuations to be stable through 2020, while 39% see them going higher. In comparison, 58% of buyers expect an increase while 35% expect stability. 12% of sellers think valuations will decline, compared to 7% of buyers.

From Citizens M&A advisors:

“This is another data point where we see evidence of restraint in the deal environment. We think some sellers were surprised by their final deal terms in 2019, which often did not match the peak multiples and terms of a few high-profile deals. We also saw a decline in the deal-close rate for 2019, another marker of restraint that could carry on into 2020.”

Buyers are more bullish about valuations



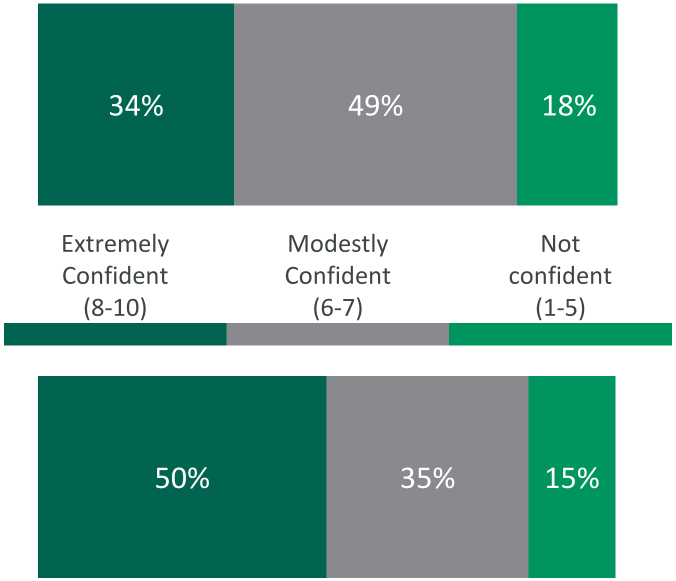
Sellers also less optimistic about getting deals done

Sellers also indicate lower confidence in the prospect of completing a deal in the year ahead. 34% said they were extremely confident about completing a deal, compared to 47% the year before.

Buyers' confidence, however, remains essentially unchanged. For 2020, 50% indicate they are extremely confident about completing a deal, compared to 49% a year ago.

Buyers have more confidence looking into 2020

Seller confidence in completing a deal
(Currently or Potentially selling)



Buyer confidence in completing a deal
(Currently or Potentially purchasing)

Some notable variation in sector outlooks

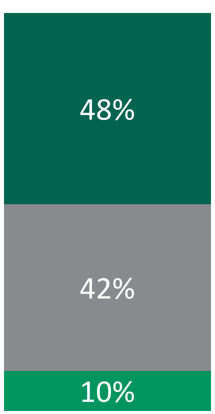
Not surprisingly, from a valuation perspective, mid-market companies report differing outlooks depending on sector.

Expectations for higher valuations appear strongest in the TMT sector, with 66% of respondents anticipating higher multiples in 2020. Responses for the year before were nearly identical.

The outlook among respondents in the industrial and consumer services sectors is more bullish than the year before, while sentiments in the business services sector have cooled. The expectations for the health care sector were in-line with the prior year.

Transportation and logistics, a new sector in this year's survey, demonstrated the most polarized outlook, with 52% anticipating higher valuations and 16% anticipating a decrease.

Tech-Media-Telco with strongest outlook, Transport/Logistics most polarized



	Healthcare	Technology/ Media/ Telecom	Industrial	Consumer services	Business services	Transport/ Logistics	Other
	C	D	E	F	G	H	I
	n= 76	76	76	75	75	75	75
Will increase	44%	66% CEFGI	41%	41%	48%	52%	41%
Will remain stable	47% D	31%	51% DH	54% DH	39%	32%	42%
Will decrease	9%	3%	8%	6%	13% D	16% DF	17% DF

Still a sellers' market, but fewer in the queue

This year's survey revealed a significant drop in the pool of likely sellers heading into 2020, down 16% from a year ago, as just 44% of mid-market companies appear to be engaged in or open to a sale.

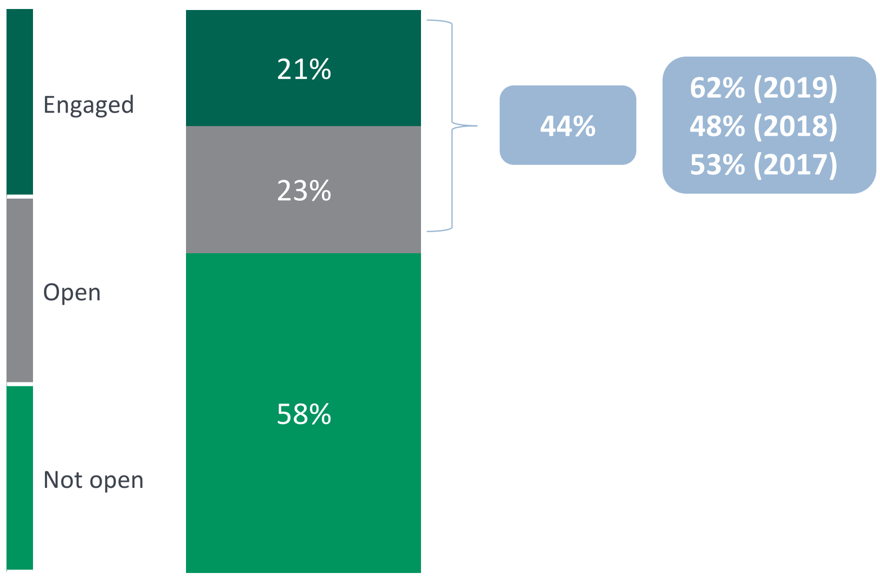
While the size of the sellers' pool has changed idiosyncratically over the years, this is the lowest reading since 2017.

From Citizens M&A advisors:

"In an environment of high valuations, it might seem surprising that the sellers' pool has shrunk. It is likely a result of several forces, including the high number of deals done in recent years as well as better organic growth prospects for companies."

"It also supports our observation that valuations are not uniformly record-breaking – buyers are being disciplined."

Selling activity
(All respondents)



Lowest % of seller activity in 4 years

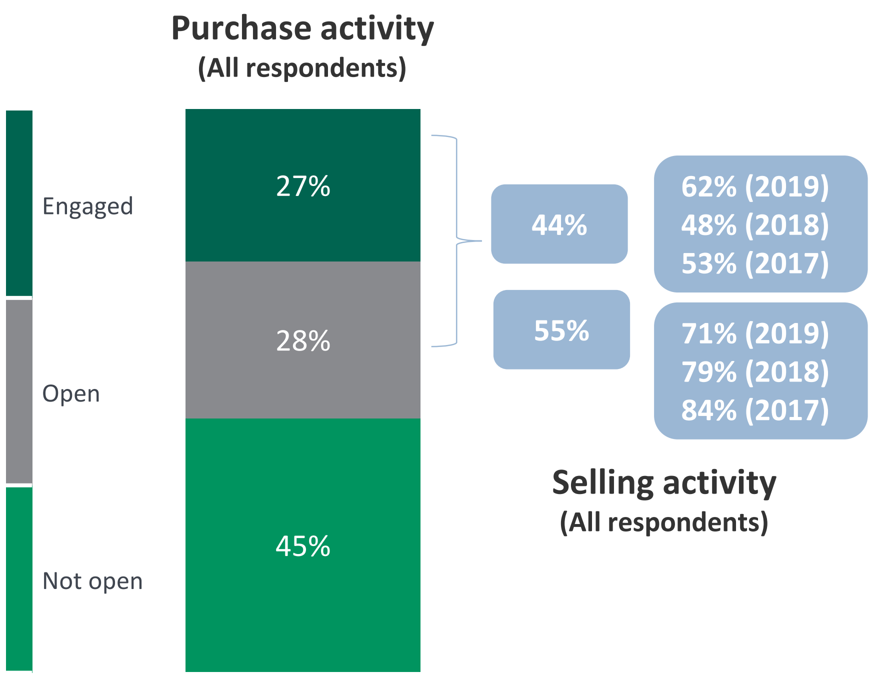
Significantly lower buyer interest, as well

The survey also revealed a decrease in the buyers' pool. Just over half of mid-market leaders, about 55%, consider themselves active buyers heading into 2020. This represents 16% fewer than a year ago – the same magnitude of decline as in the sellers' pool.

However, the decrease in potential buyers is a continuation of a trend across the last four years, down every year from a peak of 84% in 2017. After a multi-year run of strong M&A activity and ever-higher valuations, buyers continue to wait patiently on the sidelines.

From Citizens M&A advisors:

"The shrinking buyers' pool is evidence that buyers are taking a very disciplined approach to M&A activity in the current environment."



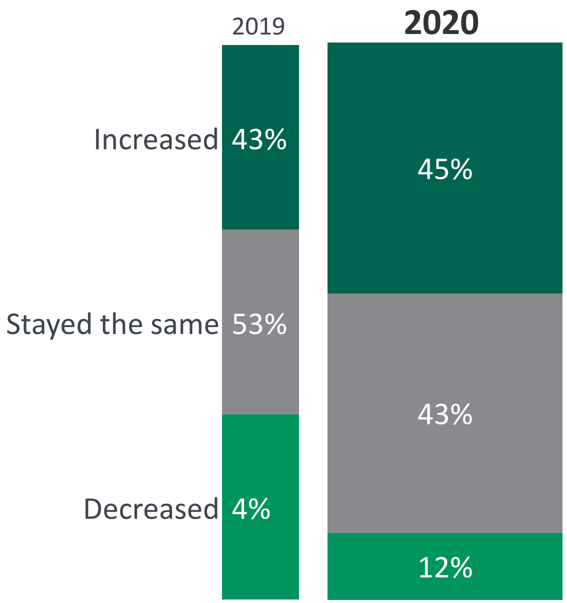
Possibility of lower deal volumes

The smaller pool of sellers and buyers could indicate that deal volumes will be lower in 2020. Another potential sign: mid-market leaders report they are receiving fewer solicitations than in the past.

Direct solicitations are commonplace among mid-market business, which report receiving two to five solicitations per month on average. 57% of respondents admit that these persistent solicitations are inducing them to consider M&A activity.

However, compared to last year's survey, we saw more companies reporting a decrease in solicitations. 12% of respondents reported a decrease in solicitations, compared to 4% the year before.

Frequency of solicitation

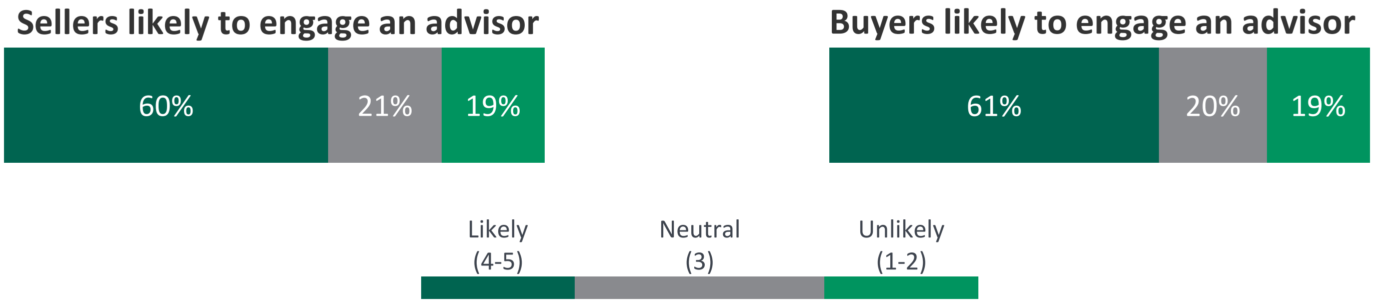


Notable decrease in solicitations

The value of the advisor remains steady

We also surveyed mid-market leaders on their views of the efficacy of M&A advisors. As in prior years, we found that the majority of both buyers and sellers indicate they are likely to hire an advisor if they do engage in M&A activity in the year ahead.

Buyers and sellers equally like to prefer working with advisor

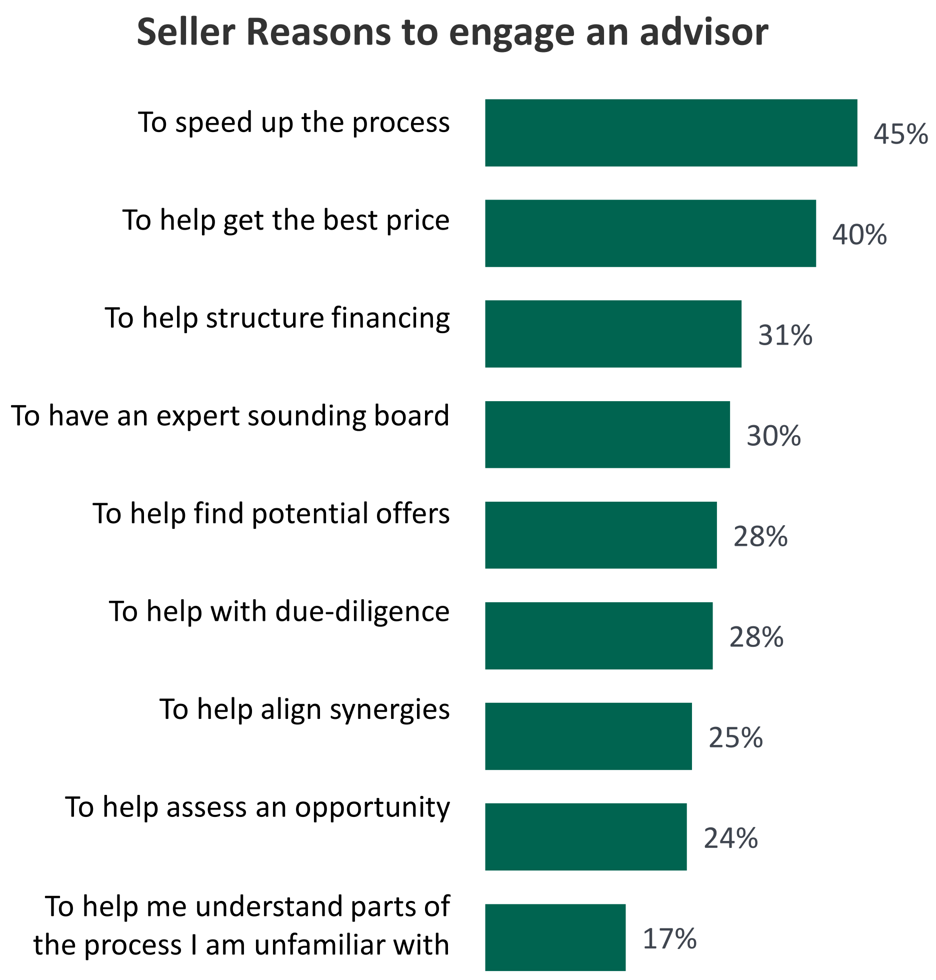


Buyers value speed, help with assessment & due diligence

Speed: that's the primary reason cited by buyers in terms of choosing to hire an M&A advisor. They also look to advisors for guidance, both in assessing value and in conducting due diligence. A third of respondents believe advisors are particularly effective in negotiating favorable deal terms.

Sellers value speed, a better price

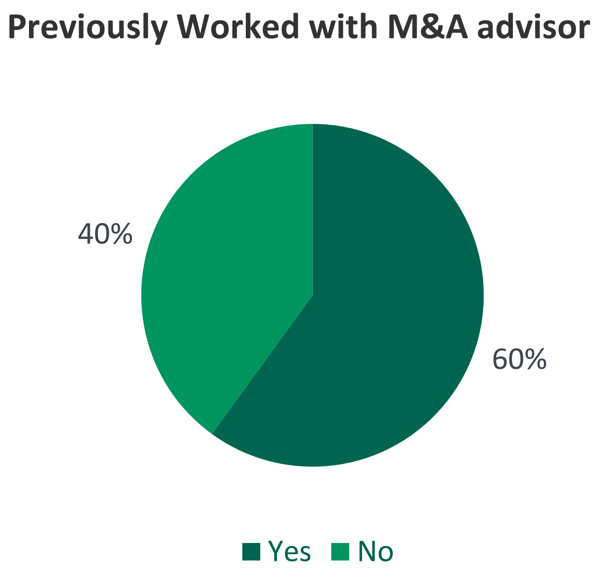
Sellers also cited speed as their top reason for engaging an M&A advisor. Four in 10 said they look to an advisor to help them get the best sale price, and three in 10 said they rely on their advisor to help access the capital markets.

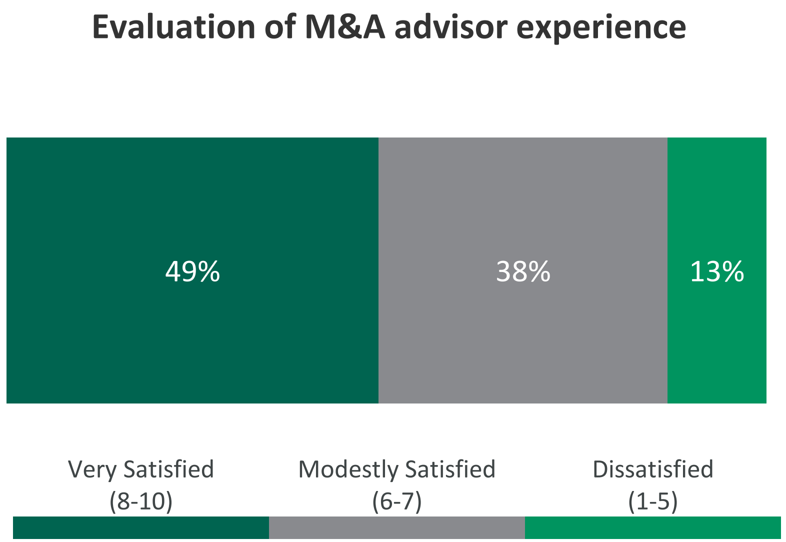


Informed by positive experiences in the past

60% of this year's respondents have worked with an M&A advisor in the past. The overwhelming majority reported being satisfied with the experience, while only 13% indicated an unfavorable experience.

Most mid-market execs have worked with M&A advisors in past





A measured approach to M&A in 2020

The mid-market leaders we surveyed offer an intriguing look into the mindset of decision-makers heading into 2020. They view the economy as strong, with less nervousness regarding a widespread slowdown, and they expect the same factors that have produced record M&A levels in recent years to remain largely intact. However, we saw nuances in their responses that gave some useful indications about how the year could shape up.

First, the impression of a sellers' market continues, but within an environment of buyer restraint and valuation discipline. Sellers are less bullish about the outlook for valuations, and they are less confident of completing a deal. There was a notable decrease in the pool of likely sellers. These responses line up with what our bankers saw over the course of 2019, that deal terms were balanced.

We think this supports the notion that buyers are approaching deals with restraint and discipline. High valuations imply high stakes, and buyers are moving carefully. Though the economy is strong, cool heads appear to be prevailing. What's more, buyers and sellers alike are reporting better organic growth prospects, which, all else being equal, lessens the dependency on M&A to fuel growth.

With a supportive economic backdrop and continued accommodative Fed policy, we believe the survey data suggests continued strength in the M&A market. However, and in large part because of this, the need for buyer discipline in terms of valuations and deal terms remains as high as ever, which could prevent 2020 statistics from eclipsing prior years' peaks.

Methodology

Survey Population	US-based mid-market businesses ($50MM to <$3B in revenue) that are currently engaged in or open to mergers and acquisitions
Profile of Survey Respondents	Business executives (Owners/Partners, CEOs, Presidents and other C-level and Directors) directly involved in decision-making related to mergers & acquisitions Core industries: Healthcare (76), Technology/Media/Telecom (76), Industrial (76), Consumer service (75), Business services (75), Transportation/Logistics (75), Other (75)
Total Completes	n=528
Weighting and Representativeness	Data were weighted by revenue and region to be representative of the total population of mid-market companies in the United States
Data Collection	November 14, 2019 – December 6, 2019
Survey Method	Phone and Web-based survey; ~15 minutes in length 528 Mid-Market Firms; Statistical significance at the 95% confidence level

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