MID-MARKET M&A PULSE CHECK 2023


Our respondents are optimistic about the near term, with expectations for an imminent tide reversal.

WELCOME TO THE MID-MARKET M&A PULSE CHECK

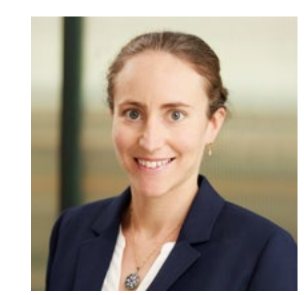
This survey is designed to measure the heartbeat of mid-market M&A in North America and identify trends in deal activity and value creation over time.

Post-COVID, the M&A Pulse Check has shown a busy market in 2021 and 2022. Last year's results, however, did hint at the beginnings of a slight softening as economic uncertainty and inflationary pressures became a building concern for investors. It is no surprise, therefore, that this year's results reveal a decline in the perceived level of mid-market M&A activity. This dip follows a period of remarkable growth for private equity and aligns with industry expectations as the post-COVID surge subsides.

However, our respondents are optimistic about the near term and their insightful contributions underline their collective belief in an imminent tide reversal. This outlook signifies the cyclical nature of the market and a conviction that opportunities will emerge as access to debt improves.

Thank you to everyone who took the time to share their views with us. We had 110 respondents throughout April and May 2023. We hope that you find the results of interest. If you would like to discuss any of the points raised in this report or the trends we are seeing in the North American M&A market, do get in touch.

GET IN TOUCH

Axel Leichum
aleichum@cil.com

Rebecca Pigula
rpigula@cil.com

IMPLICATIONS FOR INVESTORS

Market sentiment has shifted significantly since 2022, with most respondents reporting lower deal activity caused by higher interest rates, reduced access to debt and general widespread market uncertainty.

This has resulted in a move away from the seller-favorable environment noted last year to one that now favors buyers, implying that multiples are potentially softening.

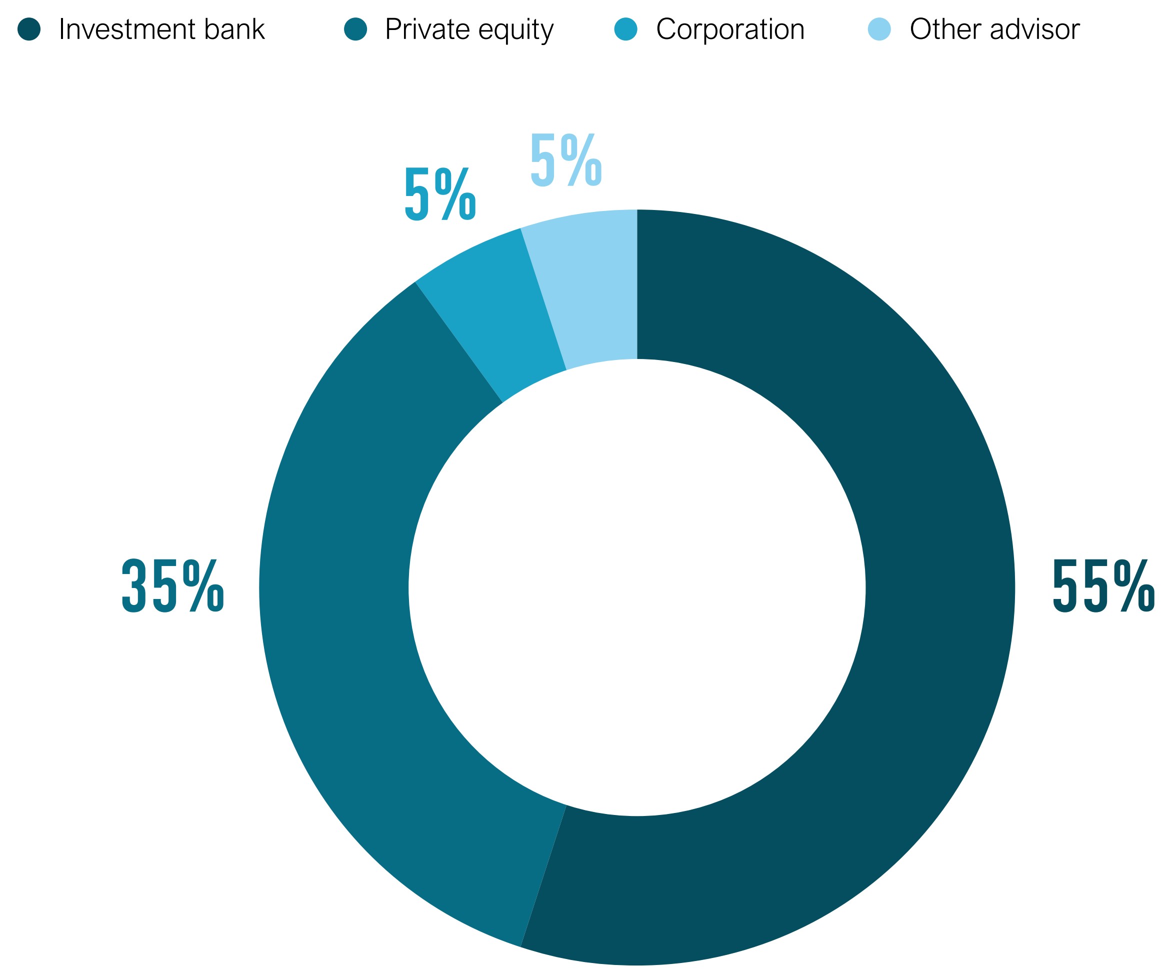
As sellers have struggled to get the multiples they want, many good businesses, particularly those that are less recession resilient, have postponed processes. Only those that have a particular time pressure, or that are truly exceptional, have forged ahead.

Respondents do, however, expect a rebound in deal activity over the next 12 months in line with easier access to debt, with over 80% anticipating that deal volumes will materially increase by the end of 2023.

Dealmakers are facing a wider range of headwinds than previous years, with access to debt and lack of quality assets becoming an increasing challenge to getting deals done. Given the reduced M&A opportunity, investors have seen this as a good time to focus on organic growth strategies, such as making operational or commercial improvements and diversifying product offerings.

80% of respondents anticipate that deal volumes will materially increase by the end of 2023.

WHAT TYPE OF ORGANIZATION DO YOU WORK FOR?



THE SLOWDOWN

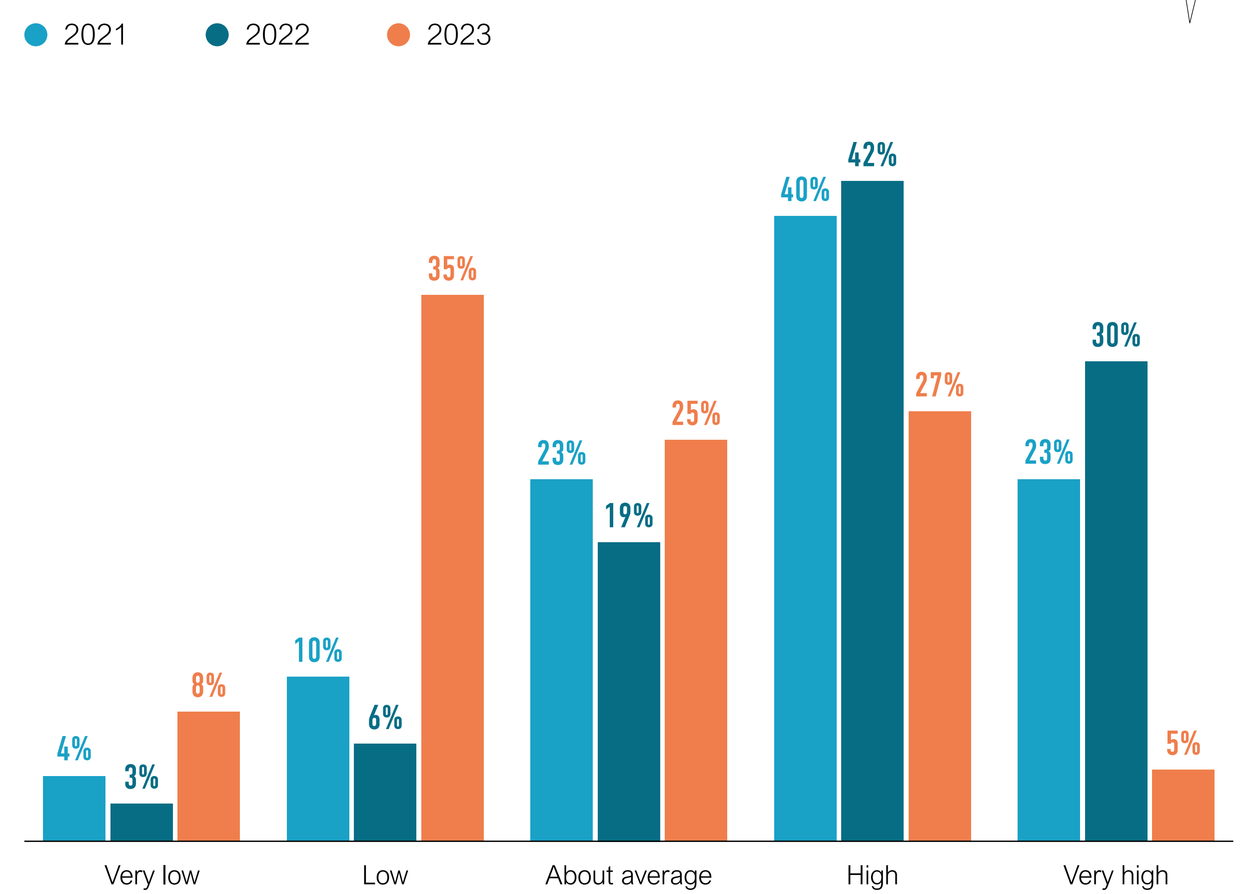
This year's findings show a drop in the perceived level of mid-market M&A deal activity. This follows a period of remarkable growth for private equity and aligns with expectations as the post-COVID surge subsides.

Approximately 35% more respondents reported 'very low' or 'low' deal activity this year versus last year.

Last year's results hinted at a slight cooling in deal activity during the second half of 2022. We have seen this play through, and then some. Rapid escalation of interest rates has curtailed debt accessibility and escalated costs quicker than expected, resulting in approximately ~35% more of our respondents reporting 'very low' or 'low' deal activity this year versus last year.

Additionally, a variety of other market challenges have arisen over the last 12 months, prompting a more conservative approach to mid-market dealmaking.

WHAT IS YOUR VIEW ON THE CURRENT LEVEL OF M&A DEAL ACTIVITY? (LAST 3-6 MONTHS)



THE BOUNCE BACK

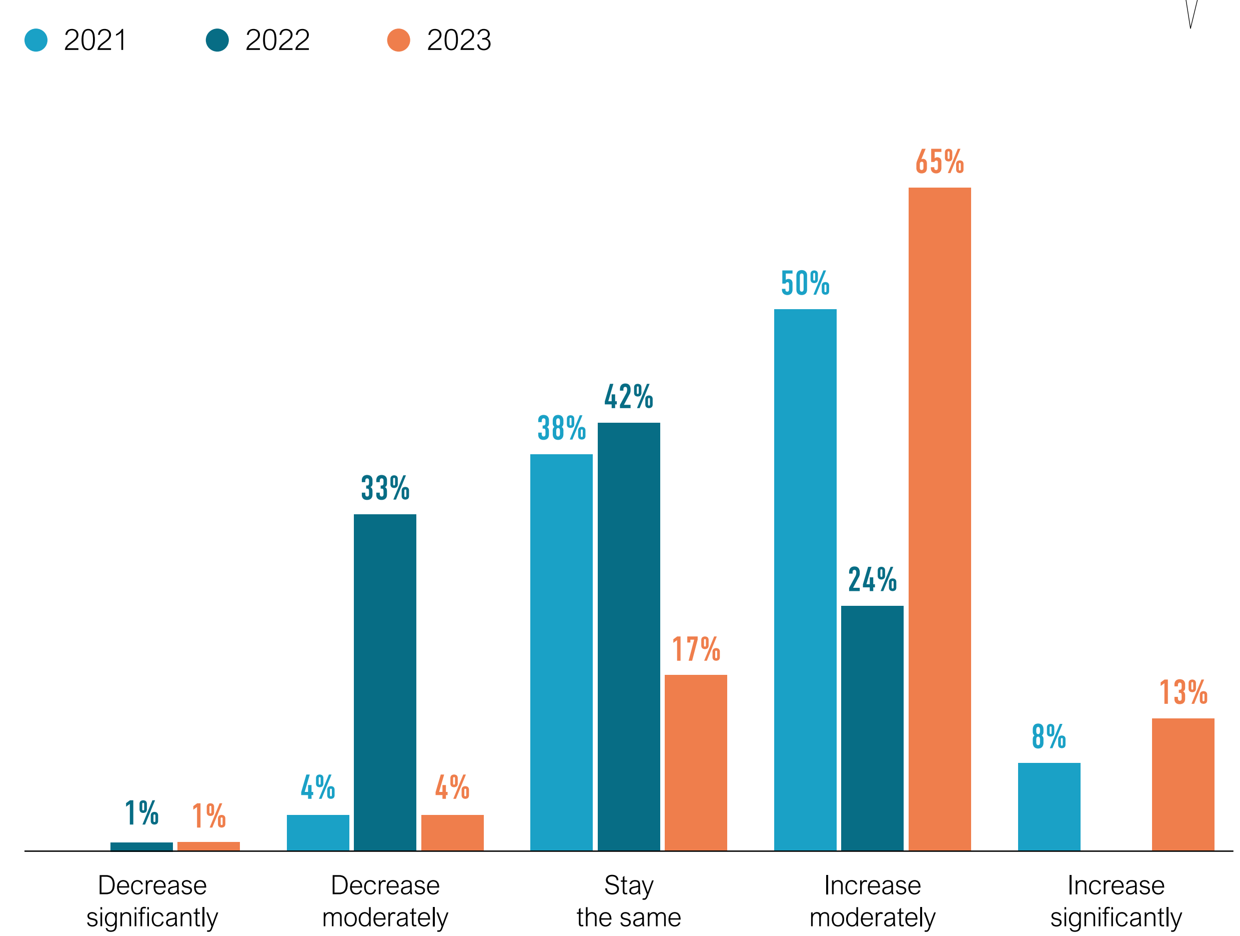
Most respondents expect a significant increase in deal activity over the next 12 months, with over 80% anticipating that deal volumes will materially increase by the end of 2023.

As time progresses, investors face mounting pressure to deploy their capital and generate returns.

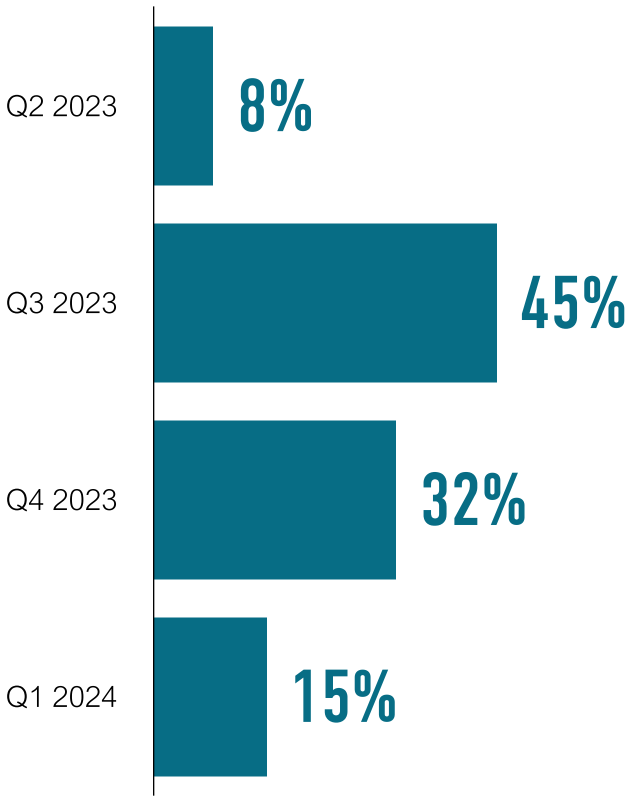
Respondents are confident in the improving market conditions and expect a boost in deal flow before 2023 concludes. This positive sentiment is fuelled by improving confidence in the economic outlook.

As time progresses, investors face mounting pressure to deploy their capital and generate returns. This growing urgency adds to the overall anticipation of increased deal activity and investment opportunities over the coming year.

HOW DO YOU SEE M&A DEAL ACTIVITY CHANGING OVER THE NEXT 12 MONTHS?



OVER THE NEXT 12 MONTHS, WHEN DO YOU EXPECT M&A DEAL ACTIVITY TO BEGIN TO INCREASE?



60%
expect interest rates stabilizing to be a key driver of increased deal activity

53%
anticipate investors needing to deploy capital and realize returns to drive deal activity

Respondents are confident in the improving market conditions and expect a boost in deal flow before 2023 concludes.

A SHIFT IN ASSET QUALITY

This year has seen a distinct polarization in the perceived quality of assets in the market.

Respondents were more inclined to rate assets as either poor or excellent this year, aligning more closely with the sentiment observed in 2021. We believe the underlying dynamics driving this divergence may be due to a couple of factors.

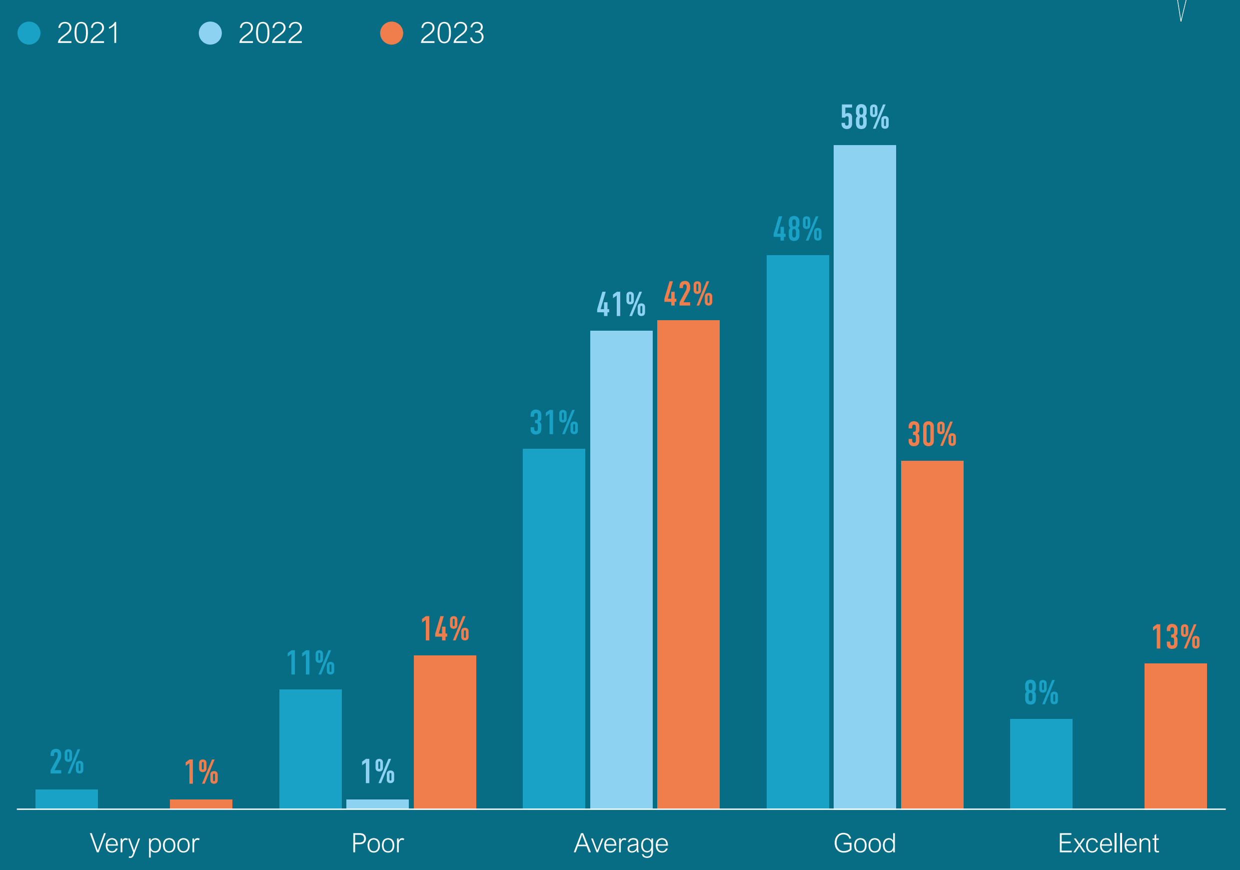
01

Prevailing market uncertainty has significantly influenced the nature of deals entering the market. Investors are increasingly gravitating towards recession-resilient assets that are anticipated to deliver robust returns on investment. Assets that can demonstrate this resilience are more likely to come to market at this time and be perceived as higher quality.

02

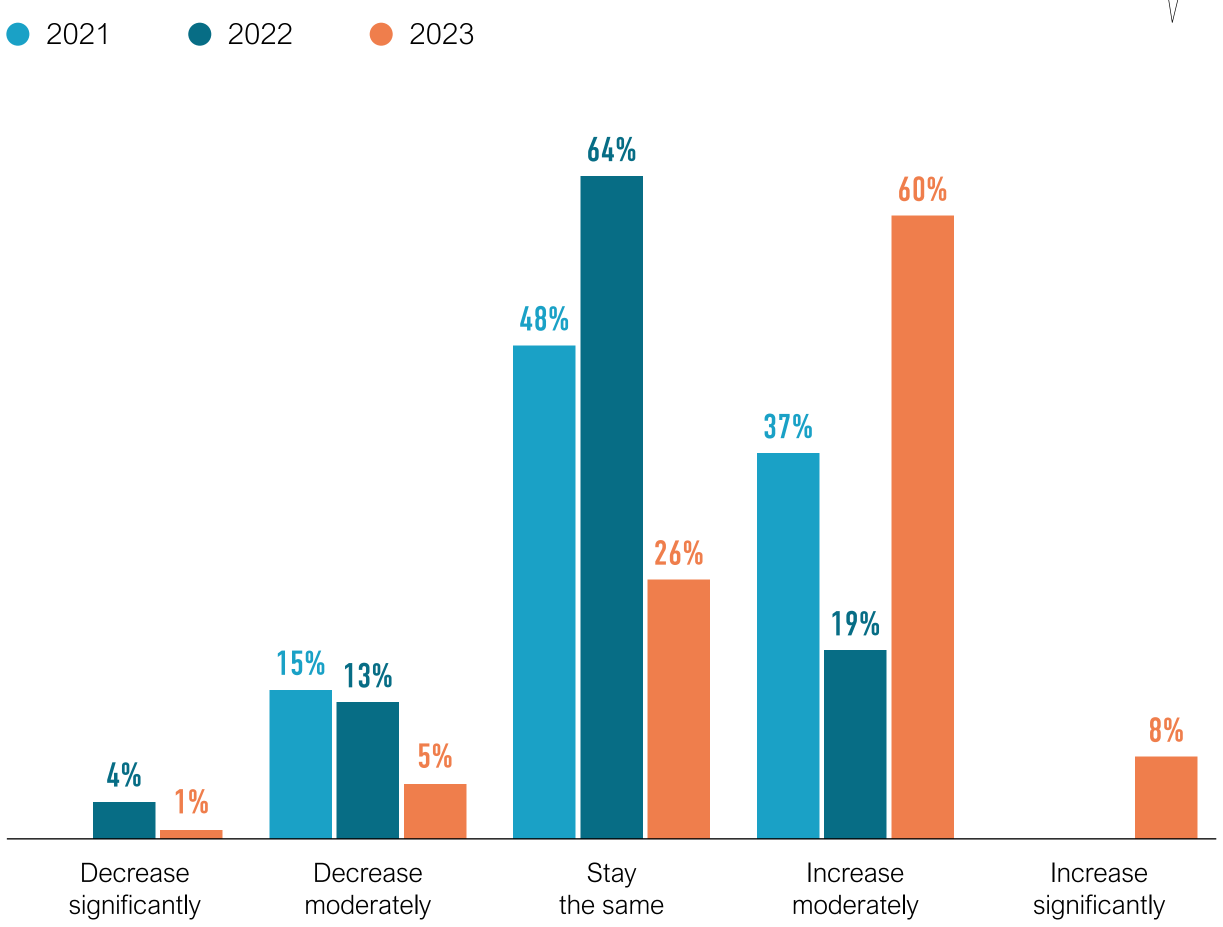
It may also be the case that assets that have come to market over the last year are those being divested by sellers unable to maintain their holdings over an extended period – they are selling because they need to. Investors may perceive these assets to be of a lower quality (albeit, not necessarily making them an unattractive investment).

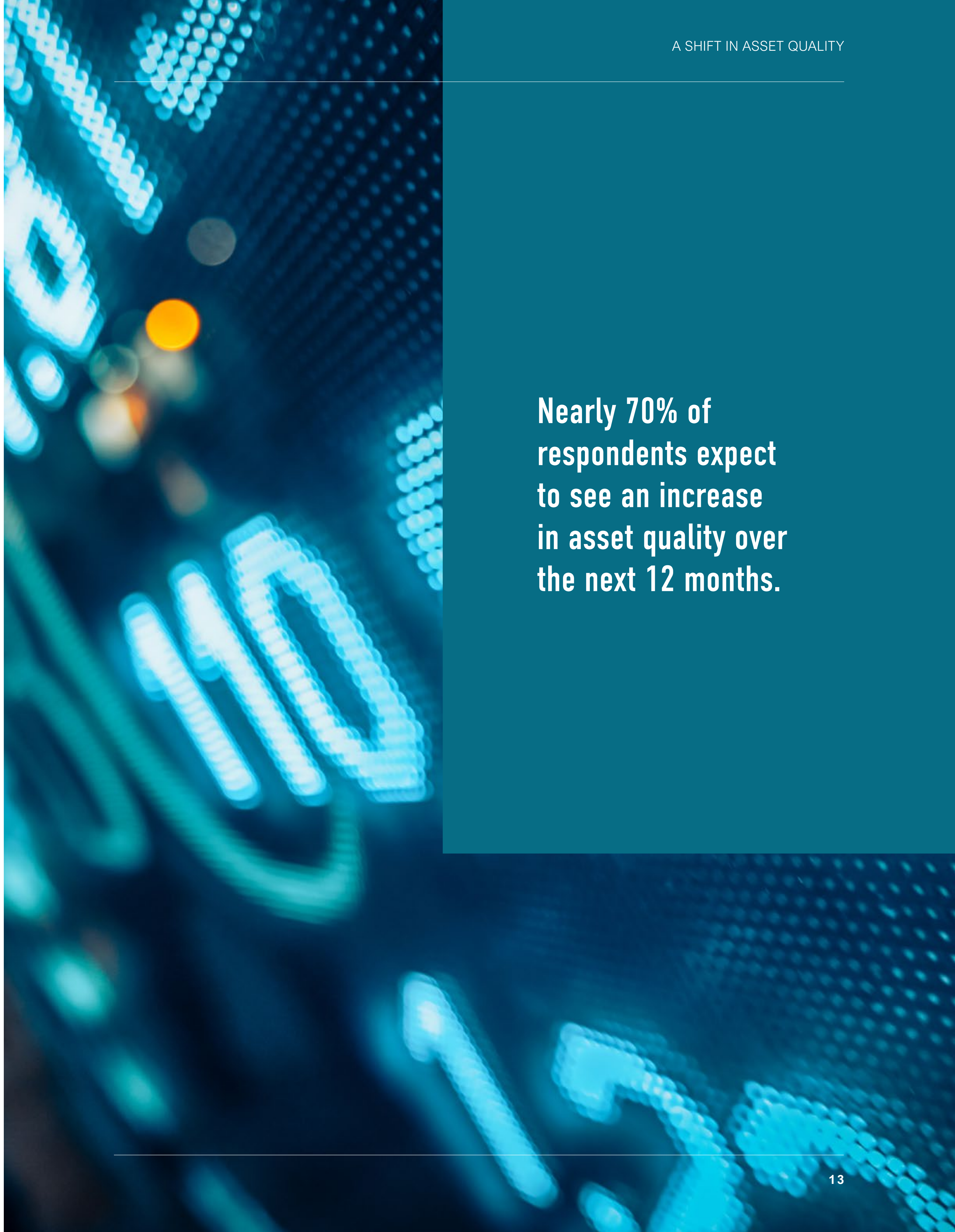
WHAT IS THE CURRENT QUALITY OF ASSETS IN THE MARKET?



> If you're going to come to market in a difficult environment, you'll want to guarantee that your asset is recession resilient.
>
> **Axel Leichum, Partner, CIL**

HOW DO YOU SEE THE QUALITY OF ASSETS CHANGING OVER THE NEXT 12 MONTHS?





Nearly 70% of respondents expect to see an increase in asset quality over the next 12 months.

BACK TO BUYERS

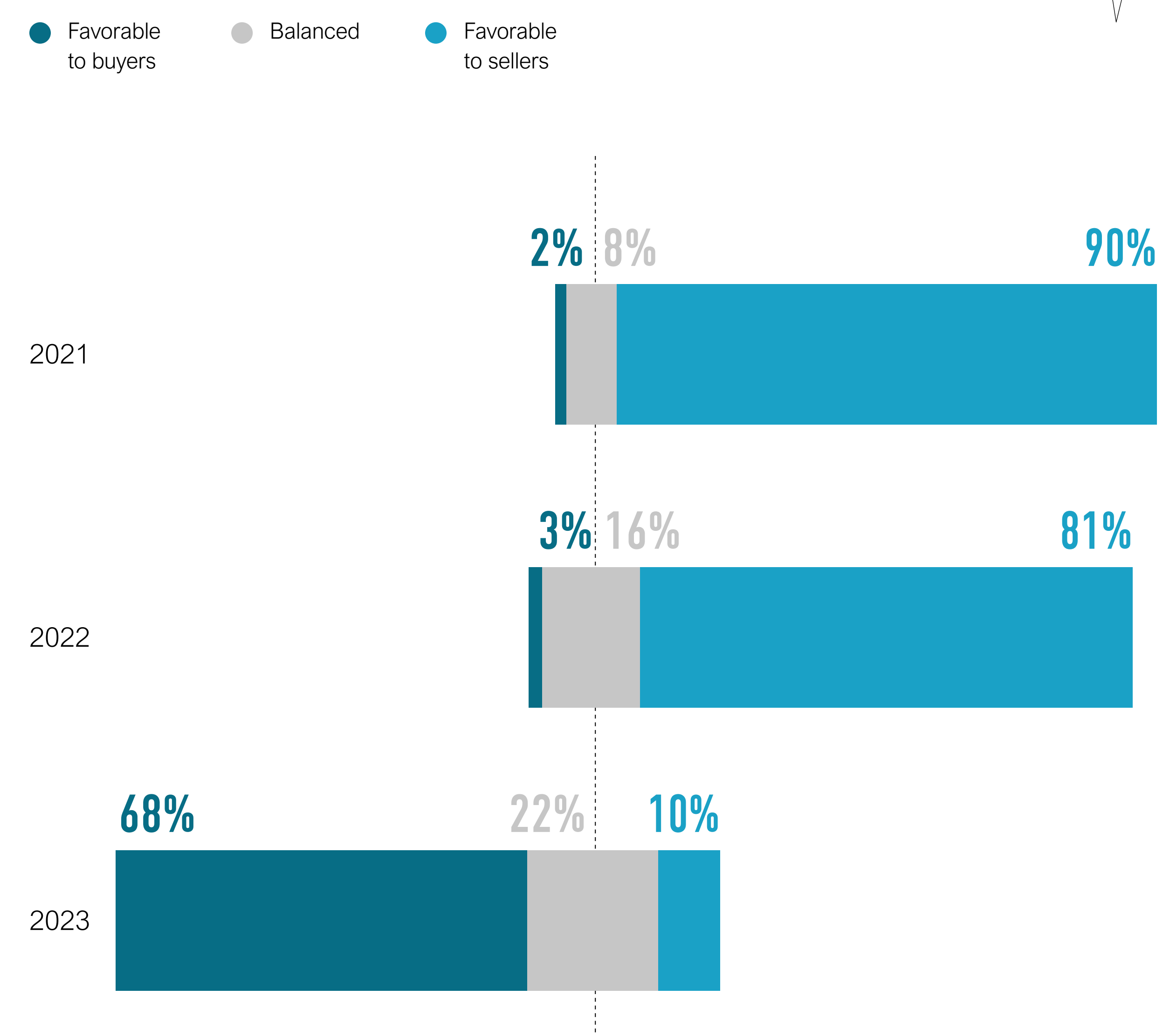
The 2023 results reveal a marked transition away from the seller-favorable environment noted in previous years to one that now favors buyers.

The market is undergoing recalibration, resulting in more realistic valuations that challenge sellers' expectations.

As the post-COVID surge subsides, sellers are encountering mounting difficulties in achieving the lofty multiples that were once attainable. The market is undergoing recalibration, resulting in more realistic valuations that challenge sellers' expectations. In contrast, buyers are positioned advantageously, able to leverage these more dampened valuation expectations and adopt a discerning approach when pursuing investment opportunities. This is particularly true of those doing smaller deals that require less debt.

This swing from a seller to a buyer-favorable market is not anticipated to be temporary. Our results show 77% of respondents are expecting to see this trend continue through the next 12 months.

WITH REGARDS TO THE CURRENT M&A MARKET, IS THE MARKET MORE FAVORABLE TO SELLERS OR BUYERS?



HOW DO YOU SEE THE M&A MARKET EVOLVING OVER THE NEXT 12 MONTHS IN TERMS OF SELLER AND BUYER DYNAMICS?

77% of respondents are expecting the buyer-favorable environment to remain for at least the next 12 months.

DIFFERENT CHALLENGES

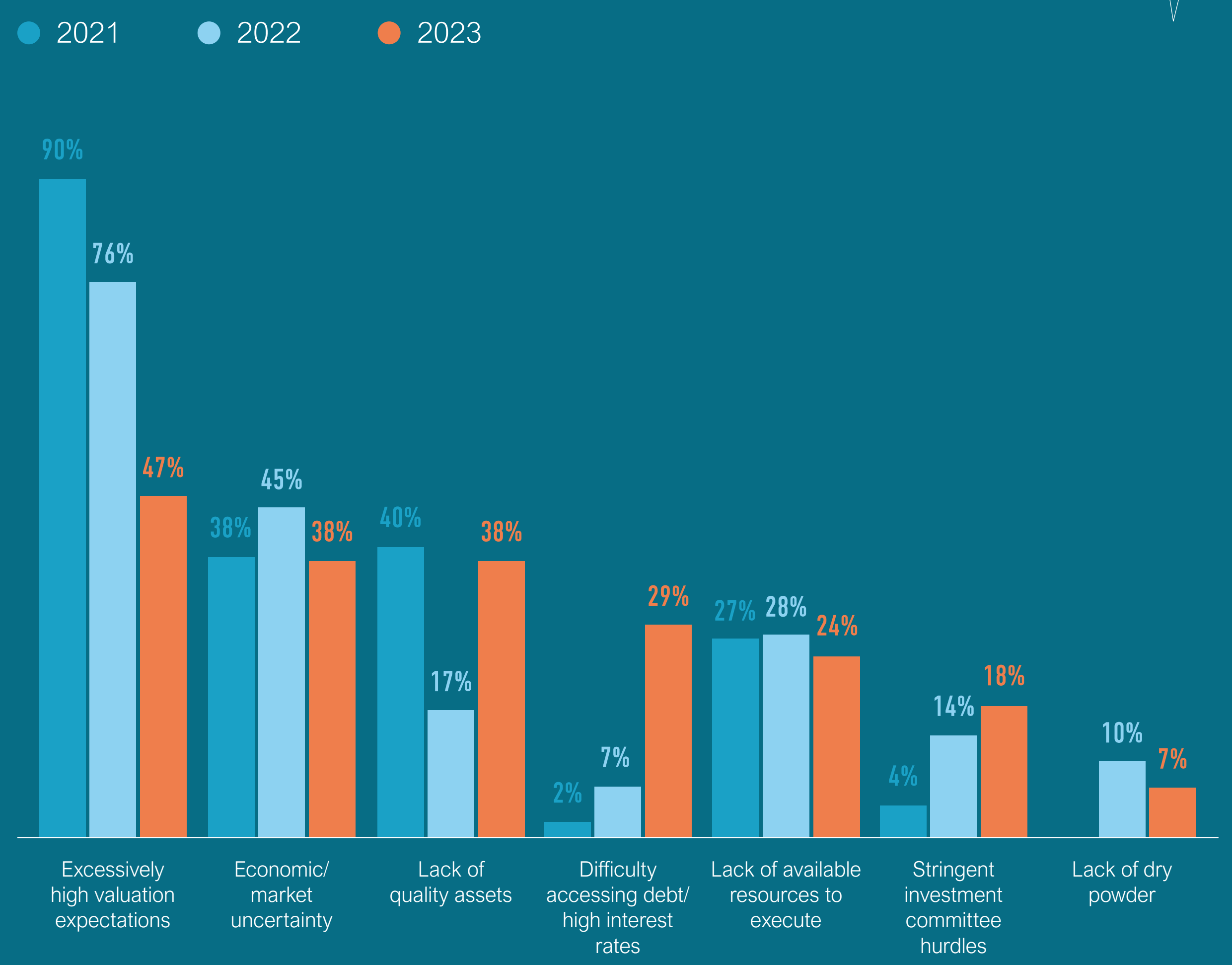
Dealmakers are facing a wider range of headwinds than previous years, with access to debt and lack of quality assets becoming an increasing challenge to getting deals done.

Excessively high valuations, lack of high-quality assets, high interest rates and economic uncertainty are all key obstacles to getting deals over the line.

Respondents highlight several key obstacles to getting deals over the line, including a lack of high-quality assets (an increase of 21% from 2022) and high interest rates resulting in difficulties accessing debt (an increase of 22% from 2022). 38% of respondents noted the prevailing market uncertainty as a key challenge, albeit this is slightly reduced compared to 2022.

Notably, excessively high valuation expectations also persist as a hurdle in deal completion with some sellers remaining stubborn on valuations, albeit to a lesser extent than in 2021 and 2022. As noted previously, sellers are generally facing a diminishing influence, and some may struggle to achieve the multiples they previously commanded.

WHAT DO YOU SEE AS THE TWO BIGGEST CHALLENGES TO YOUR ORGANIZATION BEING ABLE TO GET DEALS DONE OVER THE NEXT 12 MONTHS?



A FOCUS ON VALUE CREATION

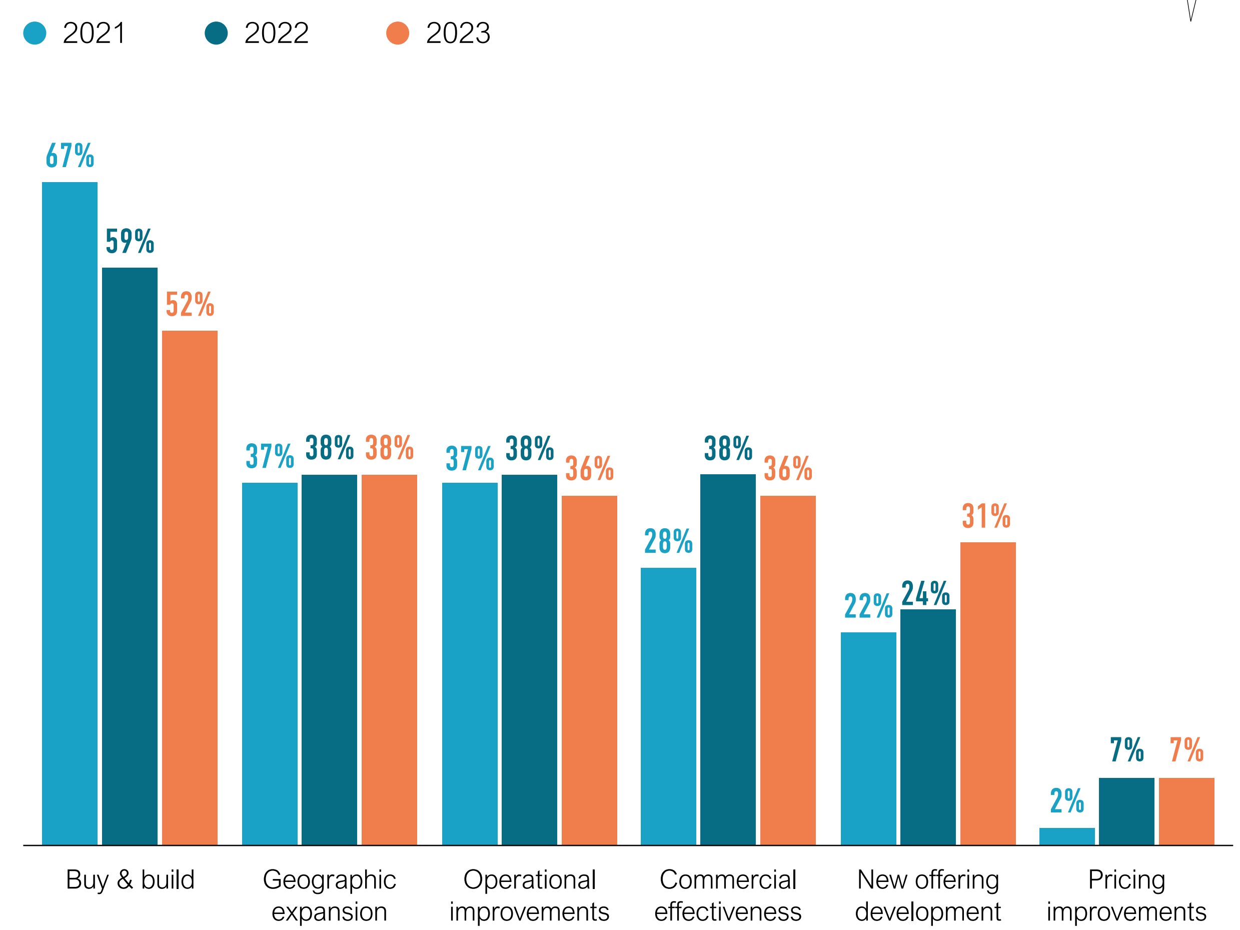
Our results show that investors continue to prioritize a variety of value creation strategies to safeguard investments and maximize returns, particularly in heightened market uncertainty.

Buy & build continues to maintain its position as the most prioritized value creation strategy, although there was also a notable shift to prioritizing new offering development.

This year's results show a notable shift towards prioritizing new offering development – with a 7% increase in respondents acknowledging it as a primary value creation strategy. This, coupled with a continued focus on better leveraging internal resources like sales and marketing, suggests a move towards driving organic growth, while M&A headwinds persist.

Buy & build continues to maintain its position as the most prioritized value creation strategy, notwithstanding a marginal decrease in the number of respondents selecting it as one of their top two strategies this year. This slight decline is not surprising, given the prevailing challenges associated with debt accessibility. However, despite these headwinds, bolt-on opportunities have continued to emerge, albeit fewer in number and varying in quality, often involving smaller businesses. Despite this, we expect this downward trend to reverse course as the economy stabilizes and market confidence increases.

FOR YOUR INVESTMENTS WHICH OF THE FOLLOWING STRATEGIES ARE YOU PRIORITIZING TO DRIVE VALUE CREATION?



A NUANCED PERSPECTIVE ON POLICY

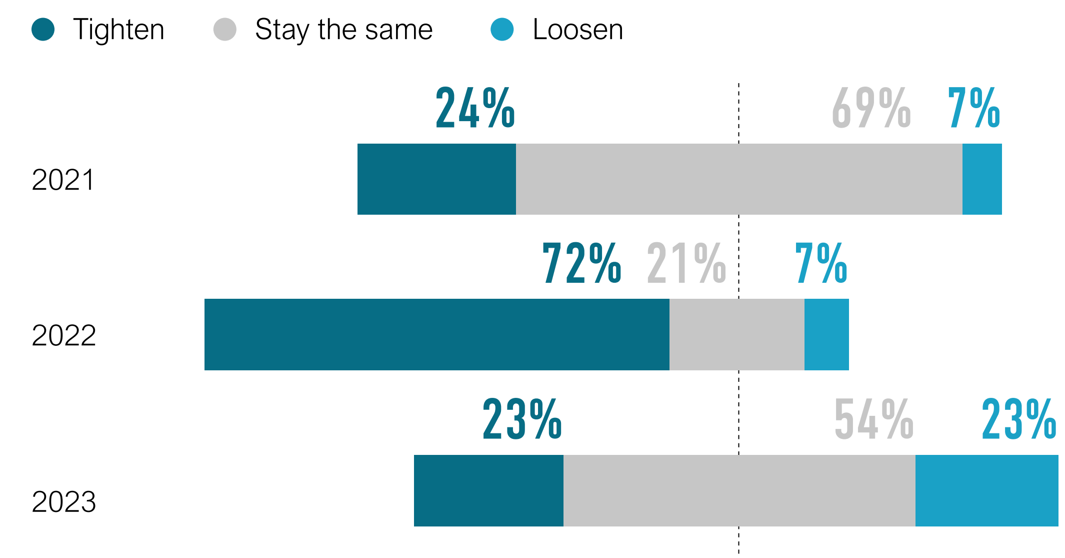
As the economy shows signs of stabilizing, respondents are generally supportive of the Federal Reserve's current monetary policy. There is a more cautious approach to fiscal policy, likely driven by concerns surrounding inflation.

Most respondents express a preference for either tightened or maintained government spending, whereas most think monetary policy should stay the same.

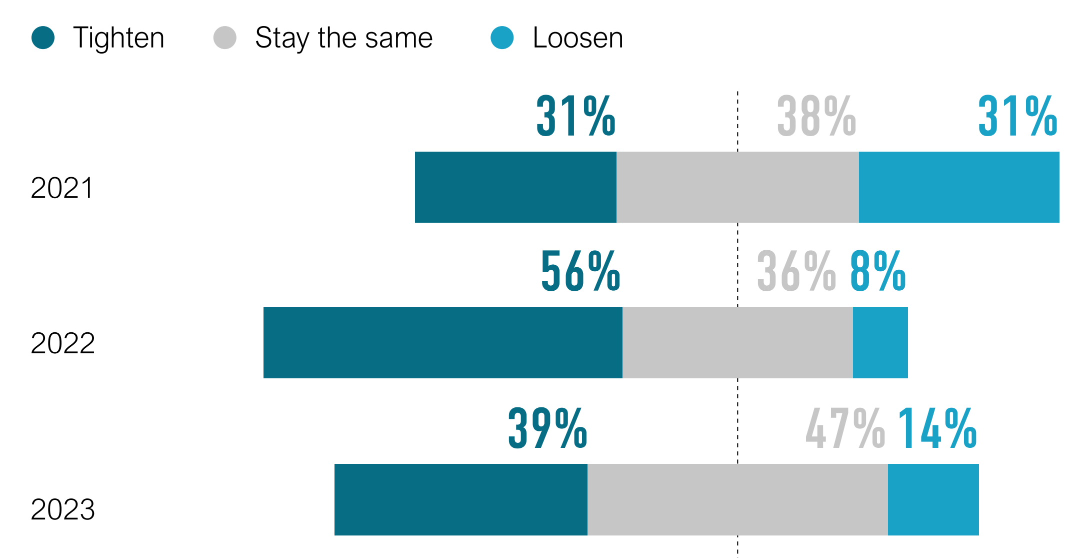
There is a noteworthy shift in sentiment towards monetary policy compared to previous years. Most respondents think that monetary policy should stay the same. In the current high-rate environment, this suggests a desire to get inflation under control.

In contrast, most respondents express a preference for either tightened or maintained government spending. This cautious stance is likely motivated by concerns surrounding inflationary pressures and the need to ensure fiscal discipline in the face of economic stabilization.

DO YOU THINK MONETARY POLICY SHOULD LOOSEN, STAY THE SAME OR TIGHTEN?



DO YOU THINK FISCAL POLICY SHOULD LOOSEN, STAY THE SAME OR TIGHTEN?



GET IN TOUCH

CIL provides growth strategy and due diligence support to management teams and investors. We are rigorous in our approach, confident in our conclusions and expert at what we do.

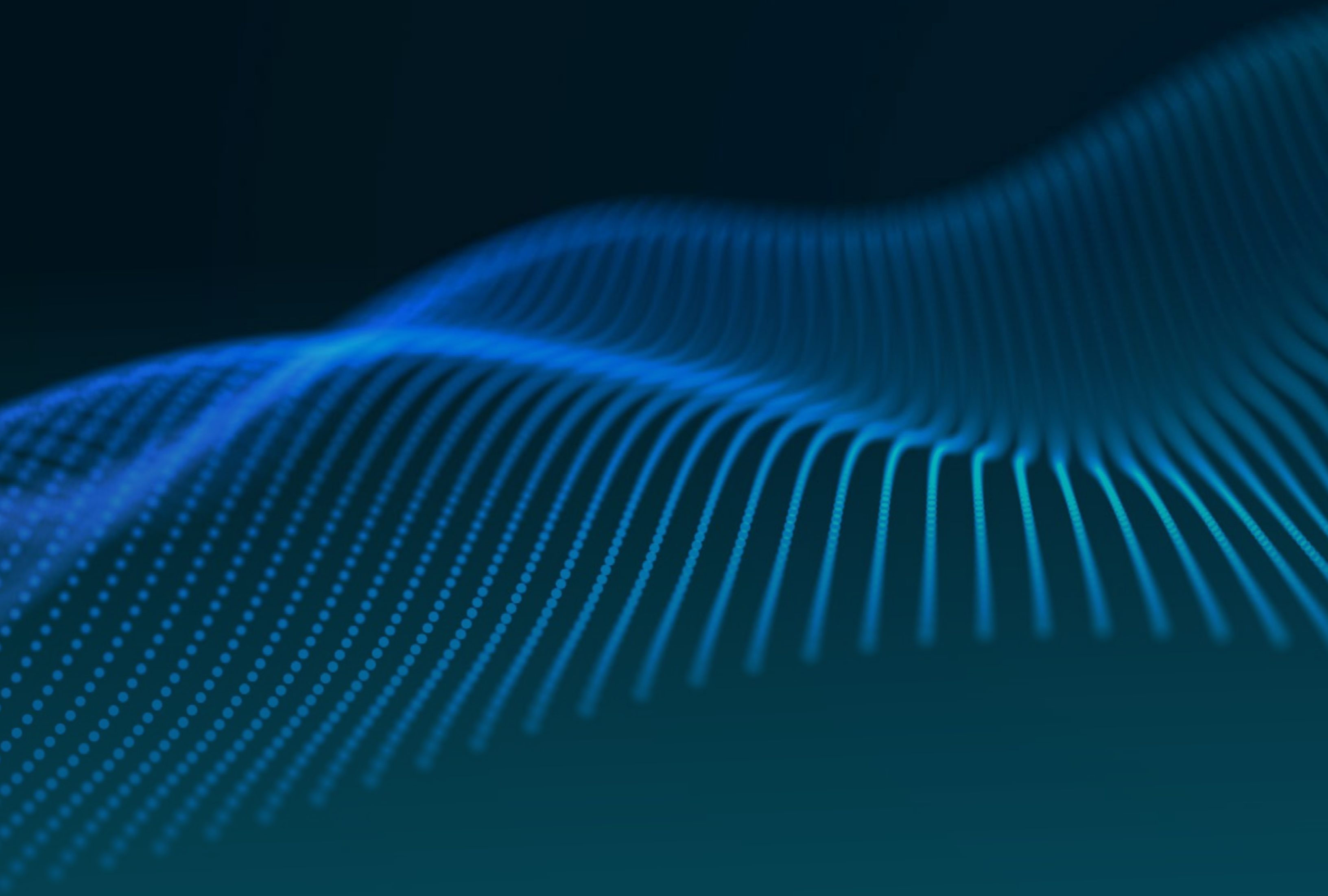
To discuss any of the points raised in this piece, please get in touch.

Axel Leichum, Partner
aleichum@cil.com

Rebecca Pigula, Partner
rpigula@cil.com

Charlotte Lamnea, Associate Principal
clamnea@cil.com

Ian Cook, Associate Principal
icook@cil.com



MANAGEMENT
CONSULTANTS

www.cil.com