

MIDDLE MARKET M&A OUTLOOK 2017





We are very pleased to share with you our sixth annual in-depth report on the current state of mid-market M&A activity. This report and its findings from surveying 600 C-suite executives are part of Citizens Commercial Banking's ongoing commitment to provide actionable insights that our customers and other organizations can use as they plan and execute strategic transactions in the near future.

In last year's survey, mid-market corporate leaders conveyed a general sentiment that it was time to act. After several years of sluggish growth fueled largely by operational streamlining and internal efficiency measures, many executives came to realize that M&A may be the best, or even only, strategy to achieve meaningful growth and meet shareholder expectations.

This same sense of urgency seems to hold true for 2017. Buyers are feeling increased pressure to show growth and Sellers are eager to get the most for their business while valuations are still high. However, a new set of market conditions following the recent national election is showing early signs of disrupting some of this thinking. Potential tax policy and regulatory changes proposed by the incoming administration may signal opportunities for a resurgence in economic growth, and even higher valuations, which have implications for Buyers and Sellers alike. This is especially true in industries that may be directly impacted by new U.S. fiscal spending priorities in the coming year.

At Citizens, we continue to expand our team and invest in the latest solutions so we can help our clients throughout the life cycle of their business. We understand that M&A decisions are some of the most important decisions a customer can make and we are here to help.

We are happy to discuss our findings with you and your team, at your convenience, especially those of you in industries that may be directly impacted by new fiscal policies foreshadowed by the incoming administration.

Bob Rubino

Citizens Commercial Banking

Executive Vice President

Head of Corporate Finance & Capital Markets

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METHODOLOGY

Survey Population	U.S.-based mid-market businesses (\$5MM to <\$2B in revenue) that are currently engaged in or open to some form of corporate development activity, including mergers and acquisitions and raising capital																				
Profile of Survey Respondents	<p>Business executives directly involved in decision-making related to corporate development</p> <ul style="list-style-type: none"> • Core titles: Owners/Partner (142), CEOs/Presidents (305), Other Development Decision Makers (153) • Core industries: Manufacturing (80), Professional Services (72), Business Services (52), Construction (45), Financial Services and Insurance (38), Retail and Consumer Products (36), Technology/Technical Services (32) 																				
Total Completes	n=600 (\$5MM to <\$25MM=201; \$25MM to <\$2B=399)																				
Weighting and Representativeness	<p>Data were weighted to align with the national population of mid-market companies based on revenue group and region.</p> <table border="1" data-bbox="565 751 1284 961"> <thead> <tr> <th>Revenue</th> <th>2016</th> <th>Region</th> <th>2016</th> </tr> </thead> <tbody> <tr> <td>\$5MM to <\$25MM</td> <td>73%</td> <td>Northeast</td> <td>21%</td> </tr> <tr> <td>\$25MM to <\$100MM</td> <td>19%</td> <td>Midwest</td> <td>24%</td> </tr> <tr> <td>\$100MM to <\$2B</td> <td>8%</td> <td>South</td> <td>34%</td> </tr> <tr> <td></td> <td></td> <td>West</td> <td>22%</td> </tr> </tbody> </table>	Revenue	2016	Region	2016	\$5MM to <\$25MM	73%	Northeast	21%	\$25MM to <\$100MM	19%	Midwest	24%	\$100MM to <\$2B	8%	South	34%			West	22%
Revenue	2016	Region	2016																		
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		West	22%																		
Data Collection	September 12, 2016 – October 7, 2016																				
Survey Method	Phone and web-based survey; ~12 minutes in length 600 mid-market firms; statistical significance at the 95% confidence level																				

AN ACTIVE 2017 IS AHEAD

2016 was an active year in M&A for mid-market decision makers, driven largely by a continued sluggish economy, a perception of topped out valuations and concerns that the period of low interest rates was coming to an end. Heading into 2017, mid-market Buyers and Sellers are feeling a greater sense of urgency to close a deal, though the post-election environment bears watching.

Just prior to the election when this study was fielded, Sellers believed the market had reached a peak and valuations wouldn't hold. Adding to that was an expectation of higher capital gains taxes, which led many to think that their window of opportunity was beginning to close. While 2016 proved that confidence didn't always translate into action, our survey showed Sellers are more optimistic heading into 2017. We found that 53% of Sellers are currently involved in or open to making a deal in 2017 (up from 34% in 2016), with 25% of organizations saying they are extremely confident that their organization will be acquired in the coming year.

For Buyers, there is increased pressure to show revenue growth after an inability to do so organically in recent years, leading to robust Buyer interest throughout the market. This belief is evidenced by 73% of Buyers indicating they are currently involved in or open to considering making an acquisition (up from 60% in 2016), with 23% of Buyers indicating extreme confidence that they will make an acquisition in the next 12 months.

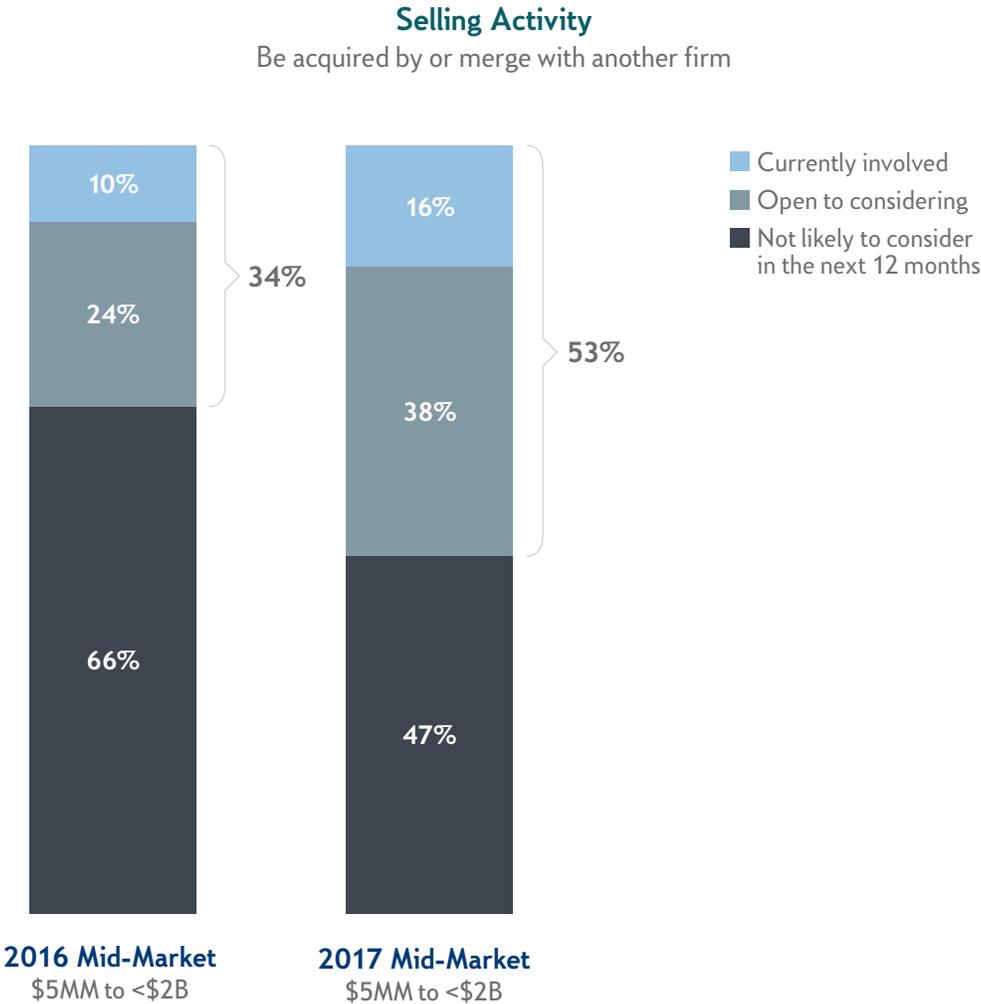
It should also be noted that prior to the national election, both Buyers and Sellers anticipated little change in the post-election business environment, regardless of which party was elected. However, early indications are that the reality may be somewhat different. A potential lowering of capital gains and estate taxes, as well as hints of a less restrictive regulatory environment and future stimulus spending, have led to a post-election rise in U.S. equity markets in anticipation of a period of accelerated economic growth. As a result, there is now a growing sense among some mid-market decision makers that company valuations may not have peaked just yet.

Regardless of how the 2017 business environment plays out, as more deals are explored, third party advisors will play a bigger role in M&A activity in the year to come. Both Buyers and Sellers are increasingly feeling the need to hire advisors and will continue to look to them for assistance in managing valuations, performing due diligence and ensuring a deal gets done to both side's expectations.

THE STATE OF SELLING IN 2017

Selling Activity is Ramping Up

The market is poised for much more selling activity than was seen last year. More than half of the market is currently involved in or open to selling in 2017, up from 34% in 2016. Mid-market decision makers understand that valuations are not likely to hold for much longer and this, coupled with looming economic uncertainty, has decision makers feeling a greater urgency to sell. It should be noted, however, that the post-election run up in U.S. equity prices may translate to an expectation among some private owners that even higher valuations are still possible in 2017, which may dampen some of their urgency to sell.



Sellers are Ready to Deal

Sellers have held out in recent years, looking for the right time to take advantage of increasing valuations. Now there is a general sentiment that valuations have reached a peak, which has Sellers prepared for a busy year. As a result, 25% of Sellers are extremely confident that their organization will be acquired in 2017. Though extreme confidence won't always translate to closing a deal, it does speak to an increased desire and a ramp up in activity from recent years.

Prepared for Sale

Overall, how prepared are you for sale?



- Prepared
- Neither prepared nor unprepared
- Unprepared

Confidence that organization will be acquired



- Extremely confident (8-10)
- Moderately confident (4-7)
- Little to no confidence (0-3)

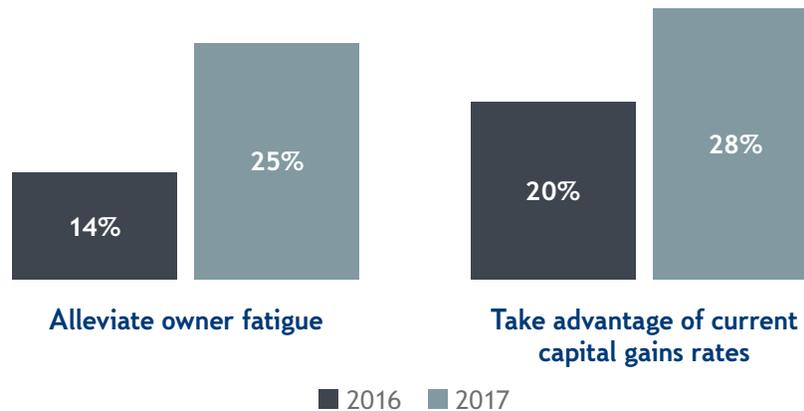
Upper Mid-Market \$25MM to <\$2B

Owner Fatigue is an Emerging Driver of M&A

The top reasons for selling have remained fairly consistent, with an emerging driver being the desire to alleviate owner fatigue. Like Buyers, Sellers have struggled to grow organically for years, leading to increased fatigue throughout the market, which is now contributing to the need to get a deal done. This is especially true among firms in the lower half of the market (36% vs. 25% in the upper half) where more executives will consider retirement in the next couple of years. Arguably, taking advantage of current capital gains rates, a major pre-election driver for Sellers, may not be as big of an issue in the post-election environment.

Top 3 Reasons Selling			
Lower Mid-Market \$5MM to <\$25MM		Upper Mid-Market \$25MM to <\$2B	
To provide liquidity to owners	50%	To provide liquidity to owners	45%
To maximize value/take advantage of current market value	38%	To maximize value/take advantage of current market value	35%
To alleviate owner fatigue	36%	To take advantage of current capital gains rates	28%

Emerging Seller Goals



Upper Mid-Market
\$25MM to <\$2B

Capitalize on High Valuations

Valuation was the top concern for Sellers last year, when half were extremely concerned with being undervalued. That number has dropped significantly, to less than one-third, this year. With valuations as high as they are, Sellers recognize that the likelihood of being undervalued is low and their window of opportunity could be closing. This sense of opportunity will lead to increased activity throughout the market, as waiting may no longer prove to be advantageous.

Top 3 Concerns Selling	
Upper Mid-Market \$25MM to <\$2B	
Meeting stated target revenue or growth goals after acquisition	33%
Losing key employees during/after sale	33%
Meeting stated target revenue or growth goals prior to acquisition	30%

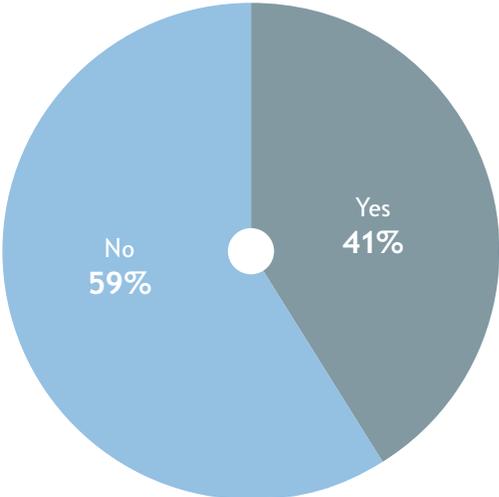
Valuation Concerns Have Dropped Significantly



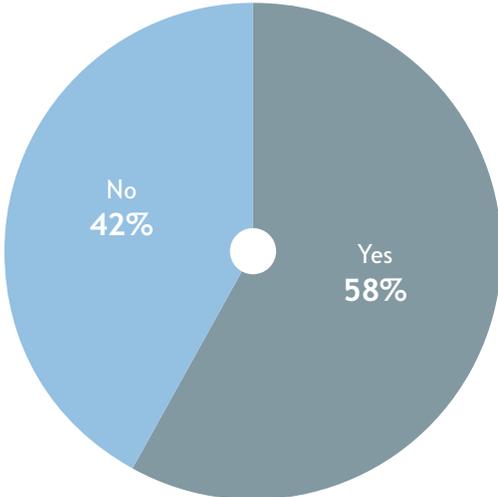
Window of Opportunity is Closing

Last year, just over 4 in 10 Sellers felt that there would be a significant financial crisis in the next 3 years, and the general sentiment was that the window of opportunity for the right deal was beginning to close — and could slam shut — as a result of a major financial downturn. This year, nearly 6 in 10 Sellers believe that there will be a significant financial crisis in the next 3 years, which has instilled an even greater sense of urgency among those selling.

**2016 Prediction:
Financial Crisis in Next 3 Years**



**2017 Prediction:
Financial Crisis in Next 3 Years**

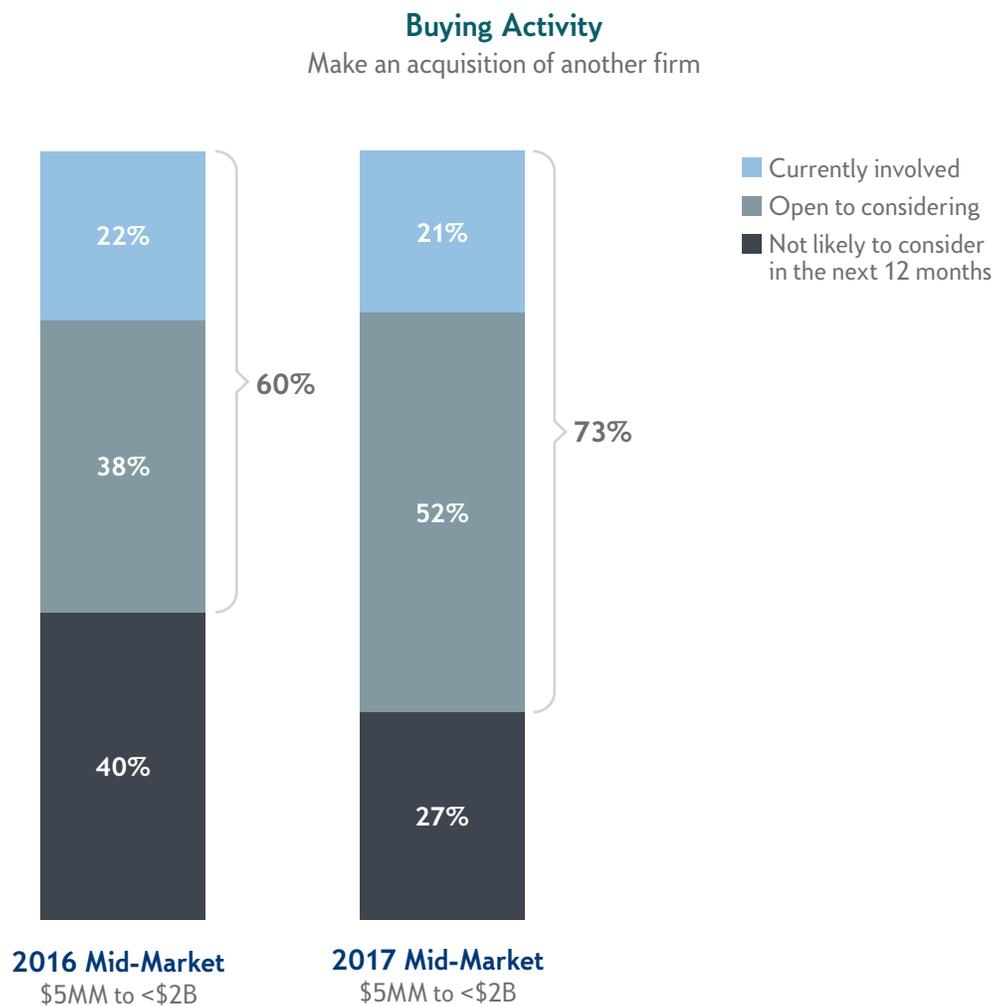


Upper Mid-Market
\$25MM to <\$2B

THE STATE OF BUYING IN 2017

Buyers Will be Busy in 2017

Nearly three-quarters of mid-market executives are currently involved in or open to making a deal in 2017, up from 60% in 2016. In 2016, Buyers struggled to find the right acquisition partner and close a deal, leaving many decision makers eager to get a deal done in the year to come. Of particular note, this increase is driven by those open to considering buying, as opposed to those currently involved in the process.



Growing Reservations Aren't Scaring Buyers Away

Despite robust interest throughout the market, Buyers do have reservations when looking to acquire another firm. Buyers' confidence that M&A will be a benefit to their organization has taken a hit looking towards 2017, with those expressing extreme confidence dropping significantly from last year. This unease is even greater among lower mid-market firms (\$5MM to \$25MM) with less than one-fifth feeling extremely confident that M&A will be a benefit to their organization in 2017.

However, these feelings have not scared Buyers away from M&A, as 23% of upper mid-market firms and 11% of lower mid-market firms feel extremely confident they will make an acquisition next year. It is important to note, even extreme confidence does not always translate into a completed deal.

Confidence Levels

Confidence that **growth through outside investment** is an appropriate strategy



Confidence that organization will **make an acquisition** in the next 12 months



Upper Mid-Market \$25MM to <\$2B

New M&A Objectives are Emerging

The top few reasons why Buyers are considering M&A remain consistent among upper mid-market executives. Increasing revenues continues to be top of mind, but new objectives are emerging. In 2017, Buyers in the upper-half of the market are viewing M&A as an essential strategy to accelerate growth and reduce the number of competitors. Lower mid-market decision makers are more focused on adding adjacent products and services that will improve operational efficiencies and help them meet expectations set forth by the market. With many organizations struggling to stimulate growth internally, M&A is seen as the only outlet for showing real revenue growth in the years to come.

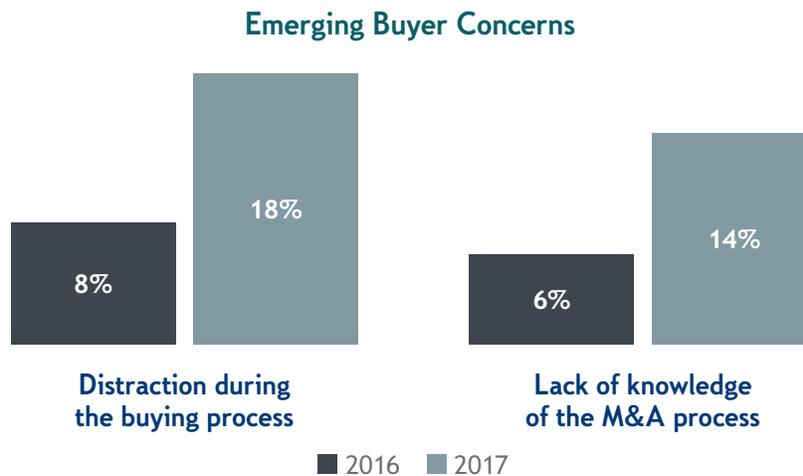
Top 3 Reasons Buying			
Lower Mid-Market \$5MM to <\$25MM		Upper Mid-Market \$25MM to <\$2B	
To increase revenues	70%	To increase revenues	60%
To improve operational efficiencies	33%	To put our cash to work	44%
To better meet market expectations	33%	To expand geographic reach within U.S.	41%



M&A Process Could be a Bigger Hurdle

Concerns over the culture and liabilities of the firm being purchased are top of mind for Buyers, as well as the fear that they will overpay while valuations remain high (the post-election run up in U.S. equity markets may add further fuel to this fear of overpayment). These top concerns are consistent with what was seen throughout 2016, but there is emerging unease around the M&A process that could stifle Buyers' ability to close a deal and jeopardize their plans for growth. Third parties are likely to play a larger role than they did in 2016, as they look to alleviate Buyers' apprehension surrounding growth through outside investment.

Top 3 Concerns Buying	
Upper Mid-Market \$25MM to <\$2B	
Inherited liability	24%
Merging differing corporate cultures	21%
Overpaying/overvaluing target firm	21%



Regulations are Having a Greater Impact Than in 2016

Buyers' confidence in the overall health of their businesses remains high looking towards 2017, with greater optimism when they consider addressing staffing needs and achieving current revenue projections. Buyers do, however, view overcoming the cost of increasing regulation as more of a concern than was seen last year. Whether this continues to be a major concern under the new administration remains to be seen.

Confidence in Organization's Ability to...

Address staffing needs



Achieve current revenue projections

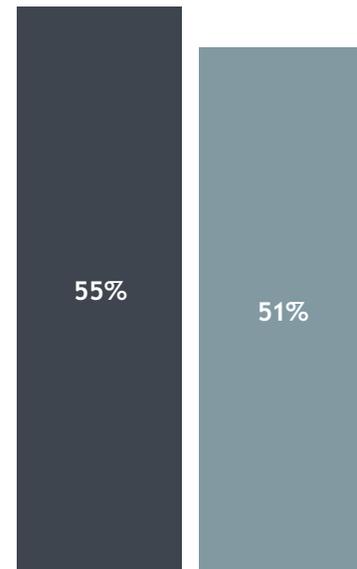


Manage the costs of increasing regulation



Extremely confident (8-10)
 Moderately confident (4-7)
 Little to no confidence (0-3)

Extremely Confident in Ability to...



Manage the costs of increasing regulation

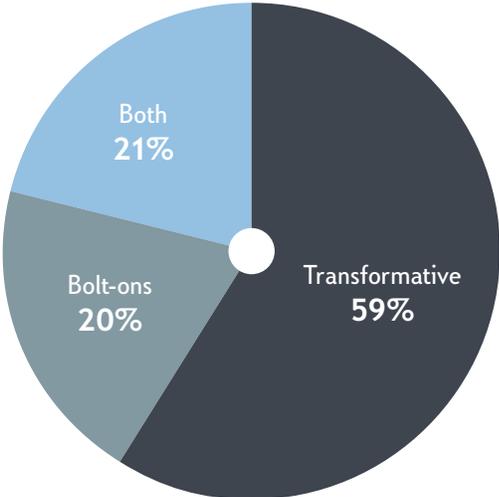
2016
 2017

Upper Mid-Market
\$25MM to <\$2B

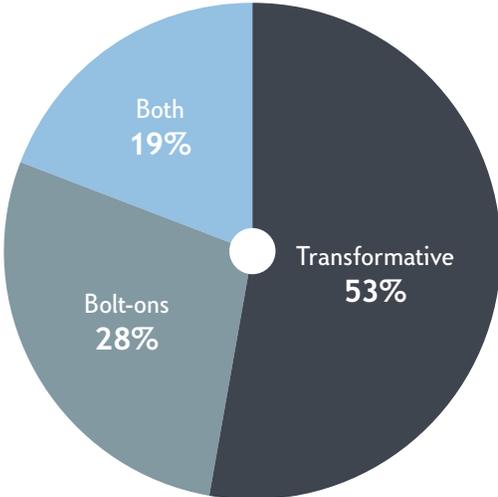
Transformative Deals are Still Preferred

While larger, transformative deals are still preferred, bolt-ons will be more widely considered throughout 2017, especially among firms in the lower half of the market (33% prefer bolt-on acquisitions). Decreased Buyer confidence in M&A and concerns around the acquisition process have Buyers seeking bolt-on deals that more closely align with their current business structures, as they strive to show growth sooner rather than later.

2016 Acquisition Focus



2017 Acquisition Focus

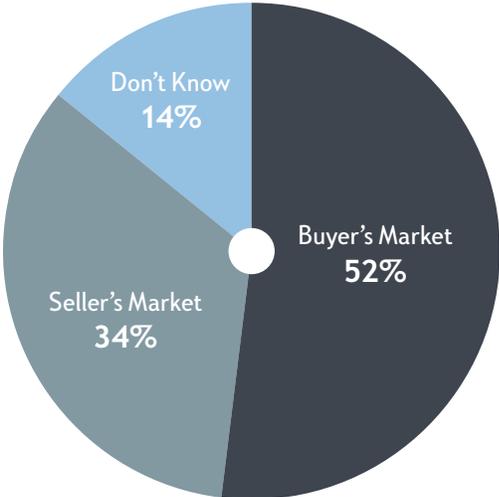


Upper Mid-Market
\$25MM to <\$2B

2017 is Well-Positioned for the Buyer

Sellers and Buyers agree that 2017 will favor the Buyer, with the balance tipping even further in their direction than in 2016. Sellers are expecting valuations to remain stagnant in 2017 (54% believe valuations will stay the same), indicating the upward trend for valuations in the mid-market may be coming to an end. Based on this belief, Sellers will look to capitalize on this window of opportunity before it closes and valuations eventually begin to taper off. Thus, a Buyer's market will likely emerge. What still remains to be seen is whether fiscal policies proposed by the incoming administration will impact some Seller expectations of even further valuation potential, especially among companies within certain industry segments.

Seller M&A Market Expectations for 2017



Buyer M&A Market Expectations for 2017

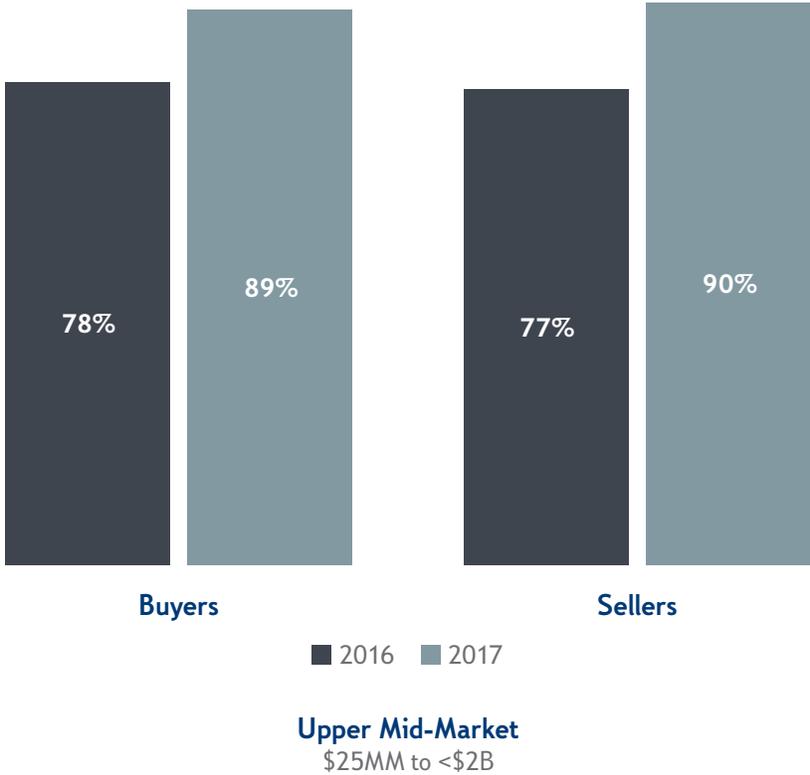


Upper Mid-Market
\$25MM to <\$2B

Third Party Support is a Must

The demand for third parties to play a role in the M&A process has reached a peak. Approximately 90% of all decision makers — whether Buyers or Sellers — will be looking to engage a financial intermediary or third party as they pursue M&A activity in the year to come. Third parties will be essential in helping decision makers manage valuations, overcome regulatory concerns and close a deal in 2017.

Proportion in Need of Third Party Services

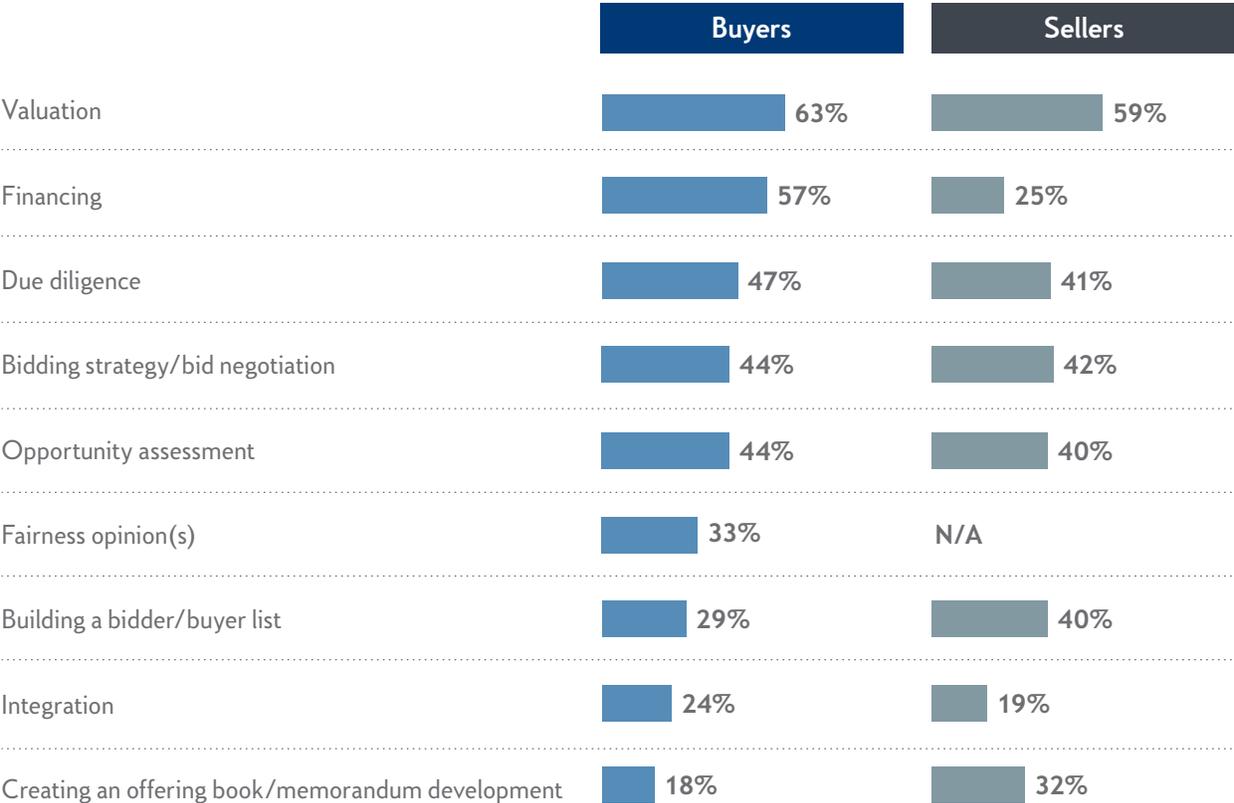


KEY TO SUCCESS: A TRUSTED M&A PARTNER

Buyers Seek Certainty of Execution and Sellers Look to Maximize Value

Buyers are gearing up to acquire, and Sellers are preparing to sell. Both sides are showing robust interest in getting a deal done, and third parties will play a key role in the preparation and execution of the transaction. Buyers are looking for certainty of execution in hopes that they can finally show some real revenue growth in the years to come, and Sellers are looking to maximize value as they view their window of opportunity as coming to a close.

Third Party Services Needed



Upper Mid-Market
\$25MM to <\$2B

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