WHY MAKING A DEAL WILL BE IMPORTANT

Middle market CEOs are under strict marching orders from investors to deliver accelerated growth in 2016. But a fragile U.S. recovery and continuing global weakness make it unlikely that organic growth alone can achieve their long-term targets. More than half of CEOs believe that M&A activity offers a more promising route to growth over the next twelve months.

Given the growth-driven rationale behind most M&A activity, it’s not surprising that 2 out of 3 buyers are focusing on transformative deals that will fundamentally change their business models or the scale of their enterprises. The less ambitious bolt-on deals – which were popular in the not-too-distant past – are now drawing interest from only 14% of middle market companies. The rest are looking for a much bigger bang for their M&A buck.

THE M&A MINDSET OF THE MIDDLE MARKET CEO

A COMMERCIAL BANKING PERSPECTIVE


A STRONG MARKET CHARGES INTO 2016

While the M&A market set new records in overall deal volume in 2015, middle market deal flow waned. However, circumstances have aligned, making 2016 a potentially robust middle market M&A environment. A third of middle market CEOs surveyed said they’re working on an acquisition right now – up from a quarter last year. And nearly as many are open to making a purchase in 2016.

Of course, every buyer needs a seller, and 13% of respondents are currently involved in a sale, with another 18% interested in selling over the next twelve months. Those figures represent a jump from last year, when just 9% were involved in a sale and 6% were open to one. So far, it looks like 2016 may even beat last year’s impressive numbers.

CEOs’ Planned Growth Strategies in 2016

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<th>Growth through M&amp;A</th>
<th>Organic Growth</th>
<th>Don’t Know</th>
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<tbody>
<tr>
<td>$25MM - $100MM</td>
<td>54%</td>
<td>38%</td>
<td>8%</td>
</tr>
<tr>
<td>$100MM - $2BN</td>
<td>64%</td>
<td>27%</td>
<td>9%</td>
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VOLATILITY & INTEREST RATE HIKES ARE SPURRING SALES – NOT REINING THEM IN

Despite the threat of more volatility this year, a quarter of middle market CEOs still plan to increase M&A activity. That’s because 43% expect valuations to rise over the next few years, compared to just 12% who think prices will fall. Afraid of being priced out, acquirers are scrambling to score a deal before the best bargains are gone. Rising rates only add to the sense of urgency.

What Buyers Want
Buyers are experiencing both expected and new concerns this year. Here are the top four reasons they’re looking to buy now:
- Increase revenues
- Better meet market expectations
- Put idle cash to work
- Buy before companies become too expensive
Almost half of the firms surveyed are confident they can raise capital to fund acquisitions, and they seem equally assured of their ability to achieve their revenue objectives. Their two main worries are inheriting liability and overpaying.

What Sellers Are Hoping to Gain
Reasons for selling have changed little in the past few years. Top motivators include:
- Provide liquidity and alleviate owner fatigue; a quarter of CEOs said retirement age affects M&A timing
- Take advantage of current market value
- Drive revenue growth
- Sell off underperforming divisions
Major concerns for sellers are undervaluation and losing key employees.

PRIVATE EQUITY IS MAKING A COMEBACK
Private equity was a relatively quiet player in the M&A space in 2015 – but it wasn’t sitting idle. PE firms have been amassing large war chests, and now they’re ready to spend. Lately, middle market CEOs have been hearing from both private equity and non-private equity players; and a quarter have been conducting their own outreach to PE firms. Almost half of the CEOs surveyed believe private equity firms are good partners for M&A transactions, and over a third said they’re more amenable to sharing ownership with private equity partners.

THE ONE CLOUD IN A SUNNY OUTLOOK
Buyers and sellers always worry about getting a fair price, and now market volatility is making everyone especially nervous. What happens if a deal falls victim to bad timing? Many public companies have watched their share prices plunge without warning. Private companies are also vulnerable to price volatility. For example, Square – a player in the mobile, debit and credit payment space – saw $2 billion vanish from its valuation prior to its IPO.1

But with all the other positive trends, market volatility isn’t frightening off most buyers and sellers. In fact, it’s motivating both of them to take action now.

EVEN IN A HOT MARKET, AN EXPERIENCED GUIDE CAN HELP
The whirlwind of middle market M&A deals that swept through 2015 shows no sign of slowing down. If anything, rising asset prices and interest rates are likely to accelerate activity, as players scramble to land last-chance deals. And in a sluggish environment, a transformative deal may be the only way CEOs can deliver on promises for growth, although they may find themselves bidding against newly reenergized private equity players.

The fly in the ointment is the problem of valuation – a tough challenge in normal times, but a source of particular worry during volatile markets. Whether they are prospective buyers or hopeful sellers, most players will find they can benefit from hearing a third-party perspective on valuation and deal options from a commercial bank or other funding partner.

ABOUT CITIZENS COMMERCIAL BANKING
Citizens Commercial Banking, one of the nation’s leading commercial banking institutions, is a division of Citizens Financial Group Inc., one of the nation’s oldest and largest financial institutions, with $140.1 billion in assets as of March 31, 2016. Headquartered in Providence, Rhode Island, the company has offices in 11 states. We help corporations, municipalities, real estate investors and non-profits build value. We partner with clients to create customized financial solutions to achieve their objectives, drawing from our comprehensive array of services including lending and deposits, capital markets, treasury services, foreign exchange and interest hedging, leasing and asset finance, specialty finance and trade finance.

Citizens operates via subsidiaries Citizens Bank, N.A., and Citizens Bank of Pennsylvania. Additional information about Citizens and its full line of products and services can be found at citizensbank.com/commercial.

1 “Square’s IPO valuation reflects tougher market for tech debuts,” USA Today, November 7, 2015.