



**CAPSTONE
PARTNERS**

Q4 2021 U.S. Middle Market Business Owners Survey

**CEOs Look to Improve Financial Stability
Amid Inflationary Period**

Contents

Survey Methodology	3
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Executive Summary	4
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01. Current Business Challenges	5
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Supply chain concerns and workforce shortages continue to disrupt businesses in a variety of industries, with commodity-dependent businesses at the forefront of the issue. In addition, rising inflation rates have driven economic uncertainty amongst business owners across industries in Q4.

02. Strategies & Initiatives	10
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COVID-19 surfaced underlying operational issues and continues to play a major role in developing business strategies. Tasked with the swift recovery of business, owners prioritized resources that pertained to addressing their most prominent challenges. In Q1, inorganic growth strategies and financial stability measures were identified as being the focus for owners as they seek to secure funding to combat inflation, protect margins, and enhance operational efficiency.

03. Revenue Impacts, Forecasts, & Economic Outlook	16
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Business owners' optimism towards their respective industries and the U.S. economy increased from the prior quarter yet continues to trail Q3 levels. Reported revenue gains in Q4 fell below Q3 for most industries. Forecasts for business conditions to return to "normal" in 2022 have improved, especially in industries that have exhibited defensibility against COVID-induced challenges.

About Capstone	20
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Survey Methodology

Capstone Partners is pleased to share the results of its Q4 2021 Middle Market Business Owners Study, providing insight into the health and recovery of small and medium sized businesses amid lingering pandemic affects, elevated inflation, and supply chain disruptions. As we continue this research, Capstone will track the performance of the middle market, recent challenges and recovery tactics, value drivers, and the changing sentiments of business owners on their respective industries and the state of the U.S. economy.

Middle market businesses are vital to the health and expansion of the U.S. economy and represent nearly one-third of gross domestic product (GDP). While information on public companies can be readily accessed, insight into privately owned middle market companies is difficult to procure. Our proprietary research seeks to provide greater insight into this crucial group, by gathering quarterly data via an online survey on how the current economic environment is impacting the operations and strategies of privately held middle market businesses.

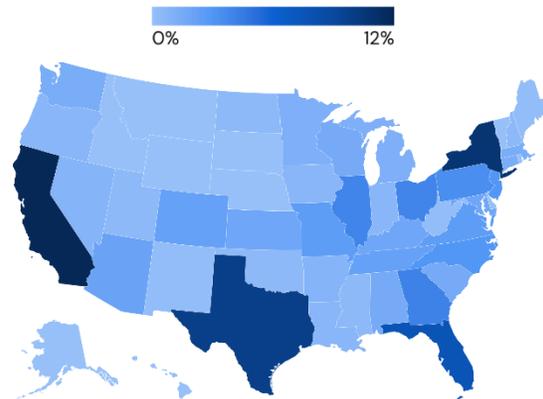
We see this as important work, and we need your help. If you wish to volunteer for future studies, please [register here](#).

About This Report

This report combines Capstone's in-depth middle market expertise with proprietary insights obtained from 430 participating owners of privately owned, middle market companies. Survey responses were collected between January 18, 2022 and March 2, 2022.

Geographic Location

Respondents to our January 2022 study were heavily headquartered in California, followed by New York, Texas, and Florida.



Industry Breakdown

Industry Surveyed	Share of Total Responses
Consumer	13.70%
Technology, Media & Telecom	13.50%
Building Products & Construction Services	13.30%
Business Services	10.90%
Financial Services	9.50%
Industrial & Manufacturing	8.60%
Healthcare	7.90%
Education & Training	5.60%
Real Estate	4.90%
Industrial Technology	4.00%
Aerospace, Defense, Government & Security	3.70%
Transportation & Logistics	3.50%
Energy & Power	0.90%

Source: Capstone Partners Research

Executive Summary

The unfolding economic volatility in the wake of the pandemic has increasingly impacted middle market business owners in Q4, with owners' economic uncertainty rising 8.5% quarter-over-quarter (QoQ). Among those CEOs that experienced economic uncertainty in Q4, 75.3% noted rising inflation as the leading issue, an increase of 14% from the prior quarter. As U.S. inflation reached the highest level in decades, all industries surveyed felt the negative impacts on business operations, with more than 50% of owners in each industry identifying rising inflation as an economic challenge.

In Q4, 93% of owners experienced at least one challenge compared to 97.3% in Q3, demonstrating the onset of recovery in the middle market. Owners have continued to focus on the immediate revitalization of business, prioritizing resources that align with their most prominent challenges. Among CEOs that experienced economic uncertainty, nearly half (49.4%) identified additional capital as a key recovery tactic and 23.6% pointed to institutional investment as a viable source of capital.

Materials availability continued to account for the leading supply chain issue (70.6% of respondents), with an inadequate supply of raw materials and available workers adding to production constraints. Commodity-dependent industries including Building

Products & Construction Services and Industrials & Manufacturing have been the most afflicted.

Looking ahead to Q1, business owners' top priority is fortifying inorganic growth strategies and financial stability to combat rising inflation, protect margins, and bolster operational efficiency. Inorganic initiatives including engaging in acquisitions and securing debt or equity capital rose 5.5% and 6.8% QoQ, respectively. In Q4, 65.3% of CEOs surveyed have been contacted by a private equity firm looking to acquire their business, with a concentration of inquiries in the Industrial Technology, Technology, Media & Telecom (TMT), and Aerospace, Defense, Government & Security (ADGS) industries. In addition, sponsors have paid an average 11.0x EV/EBITDA for add-on deals in 2021, up from 9.9x EV/EBITDA in 2020, according to [Capstone's Middle Market M&A Valuations Index](#).

The reported revenue gains among middle market companies in Q4 fell below Q3 in most industries, except for industrials and manufacturing businesses. Business owners' Q1 outlook towards the U.S. economy and their respective industries increased from Q4 yet continued to trail Q3 levels. As a result, the share of CEOs expecting a multi-year recovery of business conditions declined by 18.5% compared to Q3.

Capstone's Research Team

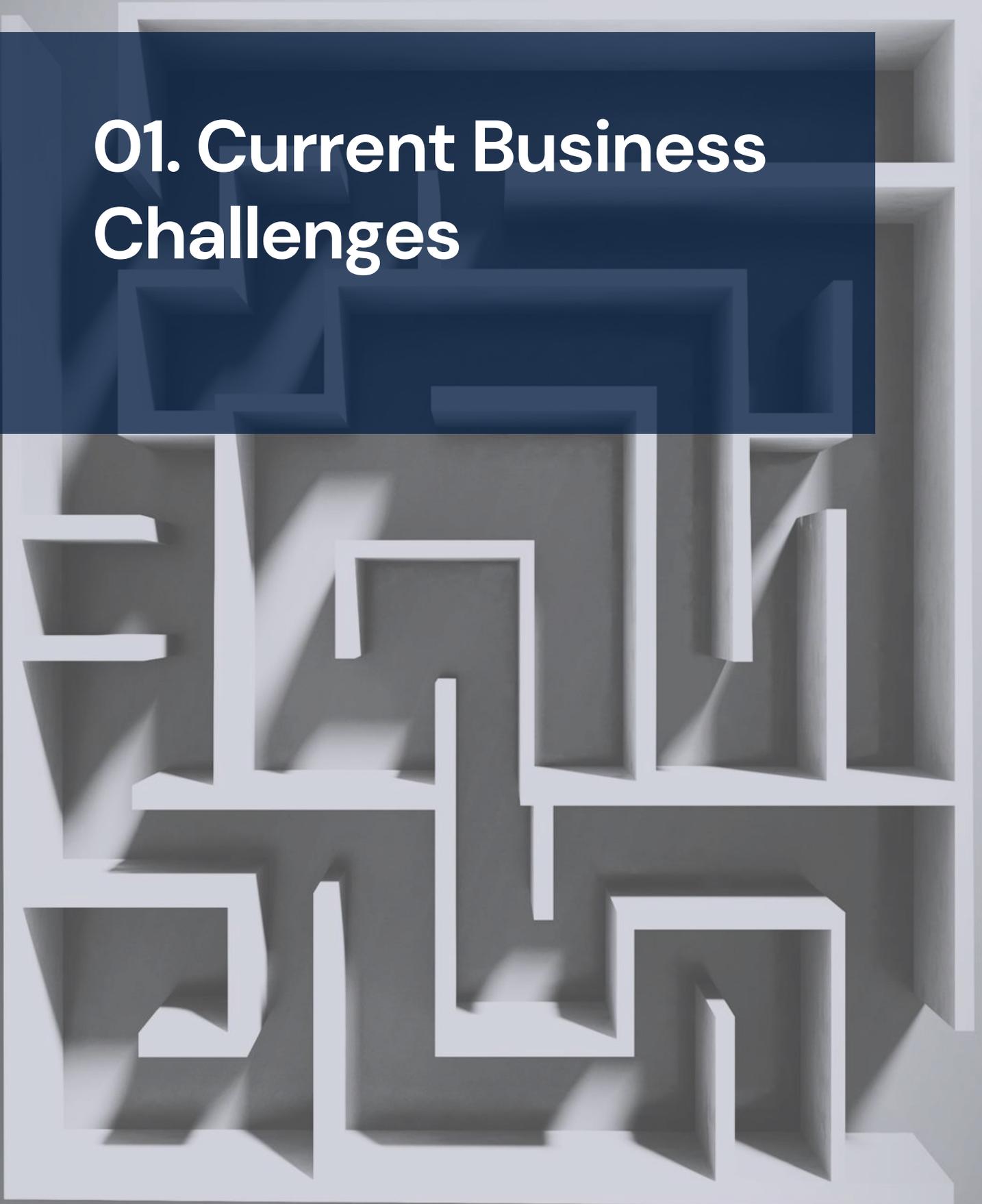
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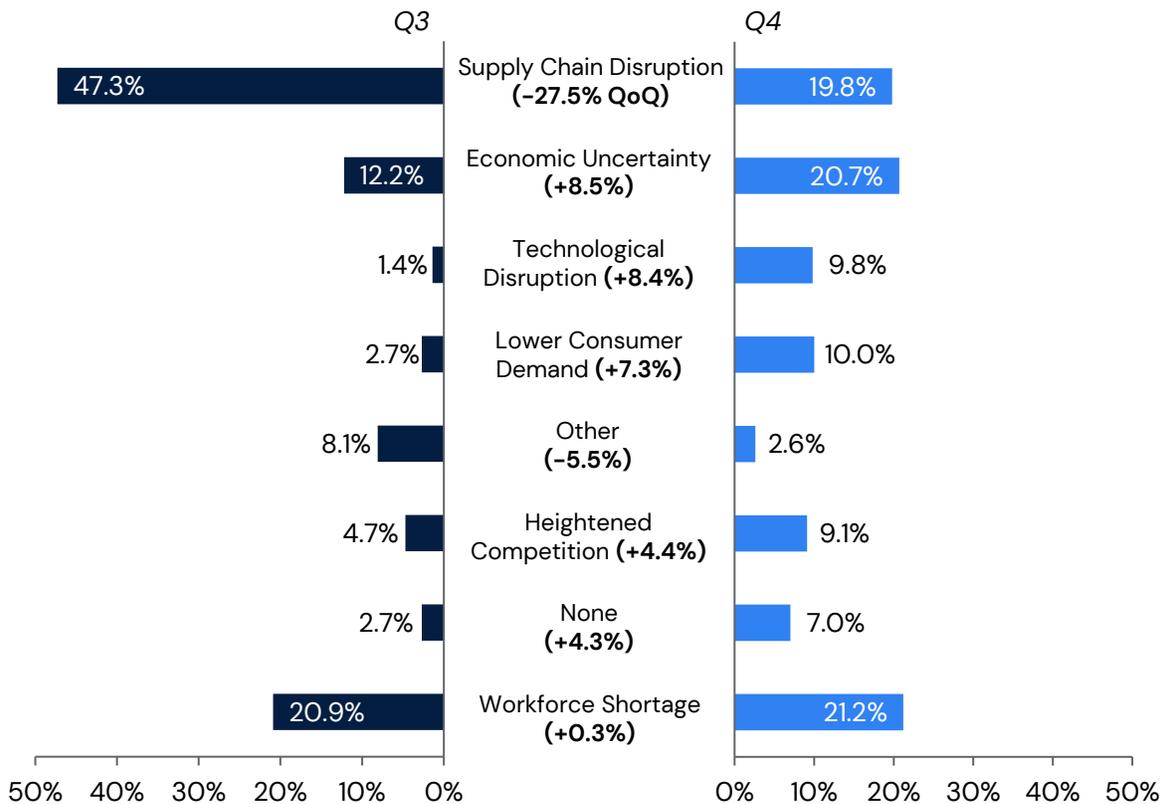
01. Current Business Challenges



Economic Uncertainties Spike in Q4

Economic uncertainties accounted for the second most prominent challenge amongst business owners in Q4 (20.7%), comprising the greatest QoQ increase (+8.5%), followed by technological disruptions (+8.4% QoQ). Among those respondents who were impacted by economic uncertainty, 18% operated in the Financial Services industry and 12.4% consisted of business services providers, highlighting the economic dependency of service-

based business models. While supply chain disruptions declined overall (-27.5% QoQ), commodity-based industries continued to be afflicted. Of note, the Industrials & Manufacturing, Building Products & Construction Services, and Consumer & Retail industries ranked supply chain issues as the top concern in Q4. Although supply chain challenges have eased from peak levels in Q3, full supply chain recovery has yet to materialize.



Question: What was the most notable challenge your company faced over the past three months?

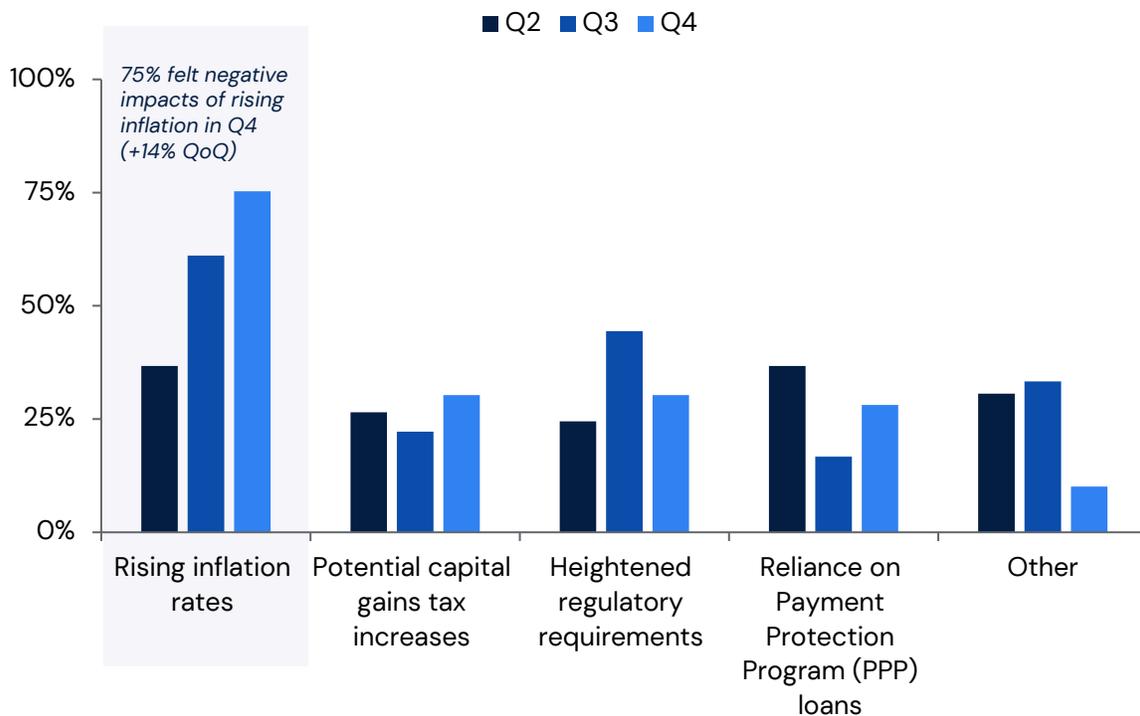
QoQ = quarter-over-quarter from Q3 to Q4

Source: Capstone Partners' Middle Market Business Owner Survey, Total Sample Size (N): 380, 148, 430

Rising Inflation Rates Increasingly Afflict Owners

Among those CEOs that experienced economic uncertainty in Q4, **75.3% noted rising inflation as the leading issue**, an increase of 14% from the prior quarter. As the U.S. witnessed inflation rates reach the highest level in decades, all industries surveyed felt the negative impacts on business operations, with more than 50% of owners in each industry identifying rising

inflation rates as an economic challenge. Services-based industries were the most impacted, with 81.8% of business services providers and 81.3% of financial services providers identifying rising inflation as their main concern. As a result, business owners have increasingly pursued outside capital as a means to offset losses during this inflationary period.



Question: What economic uncertainties has your company faced over the past three months? Select all that apply.

QoQ = quarter-over-quarter from Q3 to Q4

Source: Capstone Partners' Middle Market Business Owner Survey, Sample Size (N): 49, 18, 89

Materials Availability Disrupts Supply Chains

In Q4, business owners suffering from supply chain disruptions identified materials availability as the leading cause (70.6%), followed by rising input prices (45.9%), production constraints (38.8%), and trucking bottlenecks (32.9%). While the number of CEOs that experienced limited materials availability slightly declined compared to Q3, it remains a key issue as the lack of input goods stalled each tier.

Production constraints have emerged as a new leading supply chain issue as labor shortages have restricted businesses' capacity to scale production processes, especially in the Building Products & Construction Services and Industrials & Manufacturing industries. Without an adequate supply of raw materials and available workers, production constraints are likely to continue through 2022.



Question: What supply chain disruptions has your company faced over the past three months? Select all that apply.

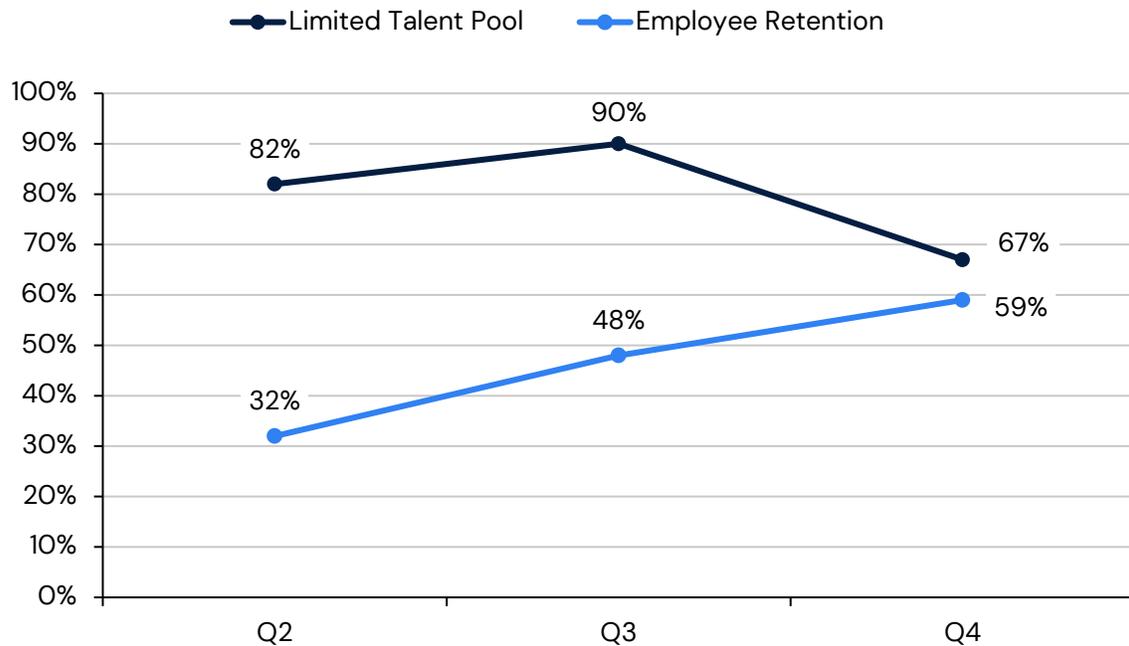
QoQ = quarter-over-quarter from Q3 to Q4

Source: Capstone Partners' Middle Market Business Owner Survey, Sample Size (N): 70, 85

Limited Talent Remains Hurdle, Retention Concerns Grow

Business owners suffering from workforce shortages pointed to a limited talent pool (67%) as the foremost hurdle faced in the past three months. Despite record-setting job requisitions in the U.S., organizations found it difficult to fill entry level positions as workers sought lifestyle changes amid the pandemic and devoted time to searching for upskilled roles. Known as the Great Resignation, this trend has severely

damaged employee retention rates, with **59.3% of CEOs having identified employee retention as a leading workforce challenge in Q4 (+10.9% QoQ)**. As employees regained control of the labor market, employers have focused on enhancing flexible working conditions and improving benefits and bill rates in an effort to retain key talent and improve employee satisfaction.



Question: What workforce challenges has your company faced over the past three months? Select all that apply.
 Source: Capstone Partners' Middle Market Business Owner Survey, Sample Size (N): 109, 31, 91

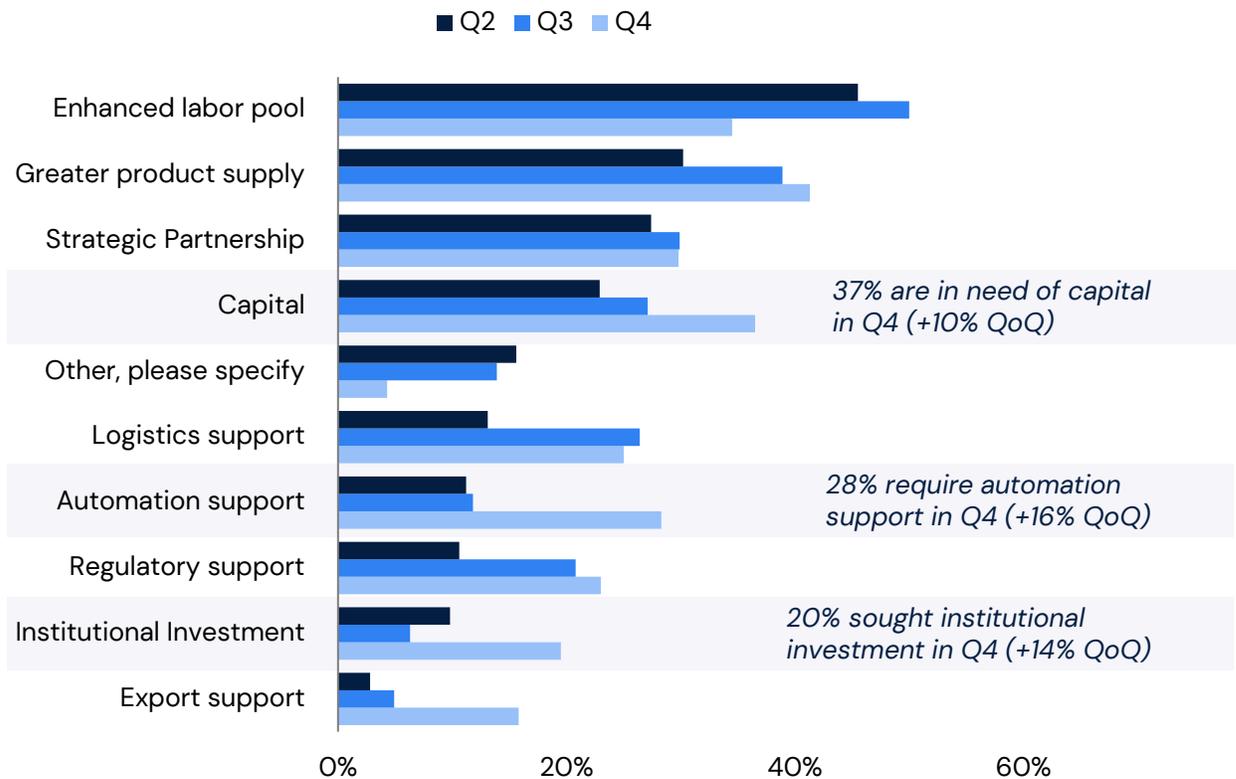
02. Strategies & Initiatives



CEOs Seek Additional Capital & Institutional Investment

In response to the recent challenges companies have faced, owners ranked recovery tactics to offset their leading issue, prompting the revitalization of their business. With lingering supply chain disruptions, 41.3% of owners stated that a greater product supply would be the most helpful recovery tactic. In Q4, 36.5% of owners identified a need for additional capital to combat rising inflation, up 10%

from Q3. Institutional investment was identified as a viable source of capital by 19.5% of respondents, an increase of 14% QoQ. Inorganic growth initiatives, comprising of capital raises and acquisitions, and corporate financial stability strategies have been top of mind for CEOs to effectively secure outside investment and protect businesses' bottom lines.



Question: Which of the following would be useful in the recovery of your business? Select all that apply.

QoQ = quarter-over-quarter from Q3 to Q4

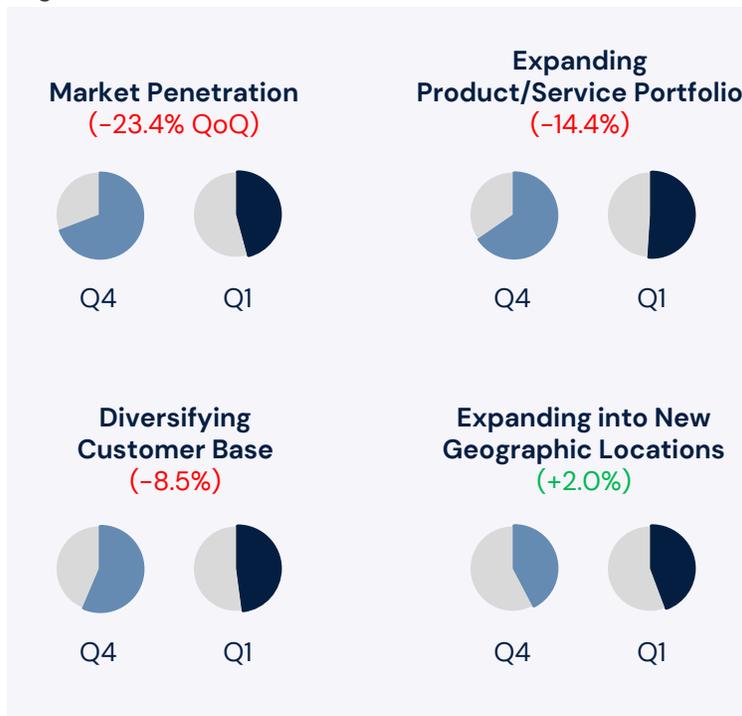
Source: Capstone Partners' Middle Market Business Owner Survey, Sample Size (N): 358, 144, 400

Business Owners Expand Inorganic Growth Strategies

In the upcoming quarter, nearly half of business owners will be primarily focusing on growth strategies (44.7%), led by organic initiatives including enhancing market penetration, expanding products and services, and diversifying customer bases to capture a larger portion of the addressable market. However, the number of CEOs prioritizing organic initiatives in Q1 2022 has declined from Q4 2021 as inorganic initiatives offer a prompt solution

to liquidity issues. In Q1, 26% of owners plan to engage in acquisitions, up 5.5% from Q4, and 28.6% are projected to secure debt or equity capital. Owners that expect to secure financing in Q1 increased 6.8% from Q4, with most businesses utilizing debt or equity capital to fund new initiatives and ensure sufficient net working capital to fulfill their growth ambitions through 2022. Many CEOs also expect the added capital will defend against economic uncertainties.

Organic Initiatives



Inorganic Initiatives



Question: Which of the following growth strategies are most important to prioritize over the next three months?

QoQ = quarter-over-quarter from Q3 to Q4

Source: Capstone Partners' Middle Market Business Owner Survey, Sample Size (N): 78, 192

Financial Stability Top of Mind Amid Inflationary Environment

In Q1, 44.7% of business owners plan to implement financial stability measures to mitigate the current inflation issues. Among those measures, operational strategies including corporate restructuring, applying for grants or loans, selling unused or unwanted assets, recovering outstanding payments, and consolidating debt represent the greatest QoQ increases. Customer-facing solutions, such as raising prices, are less likely to be administered in

Q1 compared to Q4 as clients' and consumers' discretionary spending declines. Business owners in the Consumer & Retail industry comprised the lion's share of respondents implementing financial stability measures (15.6%), followed by Business Services (14.1%), and Building Products & Construction Services (13%). Maintaining margins while protecting customer bases will likely determine clear winners throughout the inflationary period.

Strategy	Q4 2021	Q1 2022	Percentage Change
Raising prices	64.9%	44.8%	-20.1%
Lowering expenses	70.3%	54.2%	-16.1%
Corporate restructuring	8.1%	20.8%	+12.7%
Applying for grants or loans	16.2%	26.0%	+9.8%
Selling unused or unwanted assets	16.2%	25.0%	+8.8%
Recovering outstanding payments	13.5%	21.9%	+8.4%
Consolidating debt	8.1%	15.6%	+7.5%
Reengineering operations	29.7%	32.3%	+2.6%
Other, please specify	5.4%	4.2%	-1.2%
Not sure	2.7%	3.1%	+0.4%

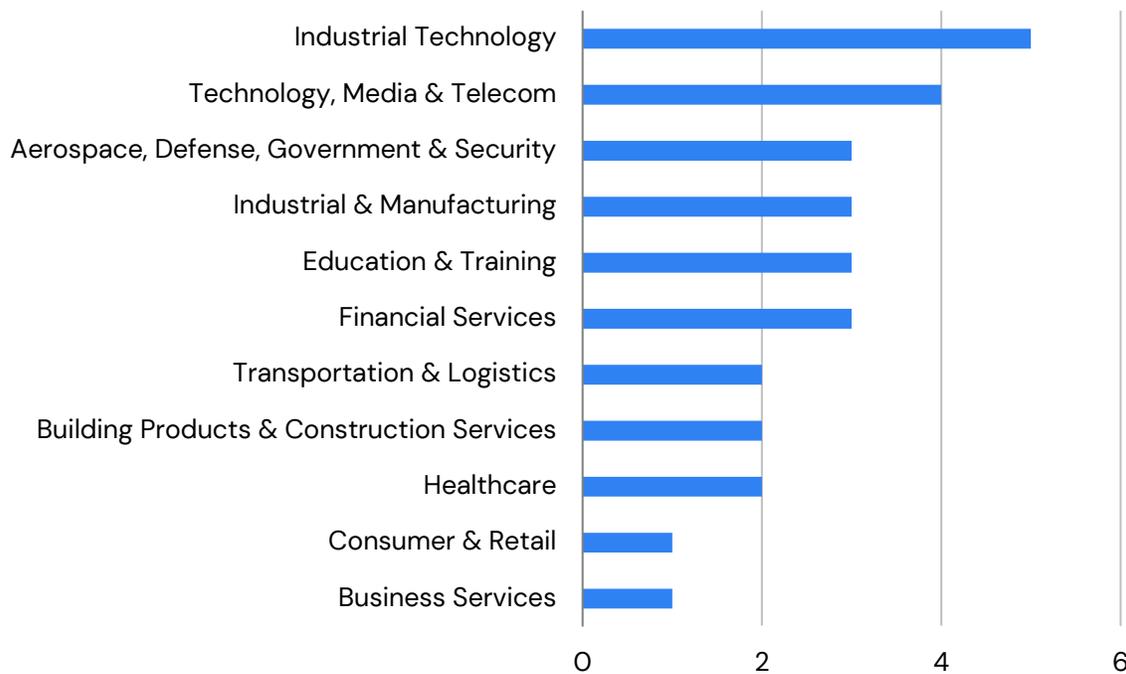
Question: How are you improving the financial stability of your company?
 Source: Capstone Partners' Middle Market Business Owner Survey, Sample Size (N): 226, 78, 192

65% of Respondents Contacted by Private Equity

In Q4 2021, 65.3% of CEOs surveyed reported that they had been contacted by a private equity firm looking to acquire their company in the past quarter. On average, private equity firms have contacted business owners two times over the past three months. Private equity inquiries have been the most frequent in technology-driven industries including Industrial Technology, TMT, and ADGS as software-enabled providers with interoperable systems enable sponsors to rapidly

integrate and scale portfolio businesses for a maximum return on investment. Armed with a record \$1.4 trillion in dry powder, sponsor deal activity experienced a banner year in 2021 with total closed transactions increasing nearly 49% year-over-year, according to [Capstone's Capital Markets Update](#). Supported by a favorable valuation environment and truncated holding times, private equity inquiries in the middle market are expected to continue at a strong pace through 2022.

Q4 2021 Average Private Equity Sell-Side Inquiries by Industry

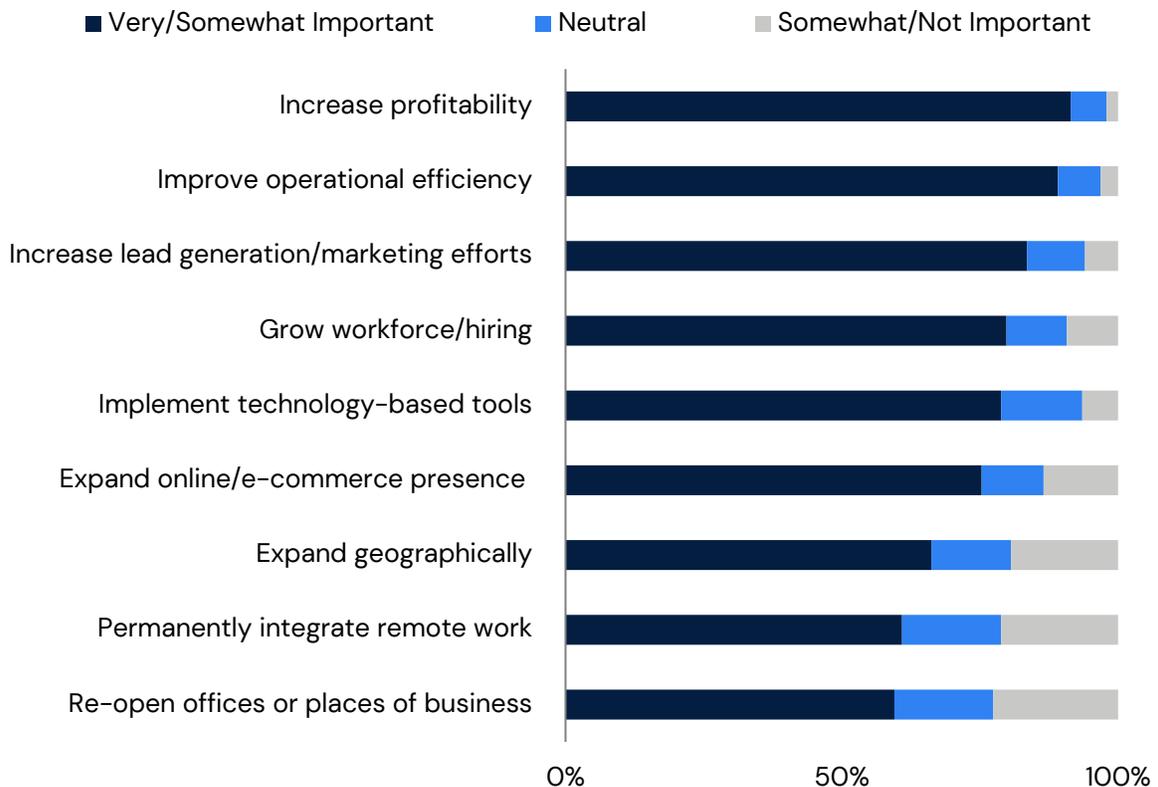


Question: How often in a single quarter are you contacted by a private equity firm looking to buy your company?
 Source: Capstone Partners' Middle Market Business Owner Survey, Sample Size (N): 430

Business Owners Plan to Bolster Internal Processes

Top priorities for business owners looking ahead to Q1 include increasing profitability (91.4%), improving operational efficiency (89.1%), and increasing lead generation and marketing efforts (83.5%). **Middle market business owners will continue to focus on enhancing internal processes rather than outbound sales efforts in Q1.** Owners that have identified increasing profitability as very or somewhat important increased 2.2% QoQ and the importance of

operational efficiency rose 14.8% QoQ. In addition, permanently integrating remote work and the reopening of offices remained the lowest priority for Q1. Many places of business have already returned to in-person work despite new variants of COVID-19, with business leaders prioritizing the redesign, reorganization, and rebuilding of office spaces to ensure compliance with new regulations and enhance productivity for employees.



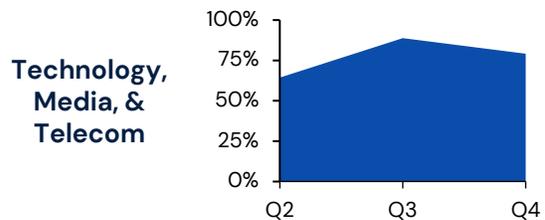
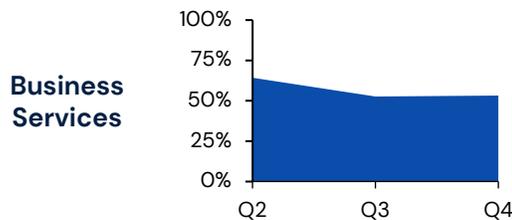
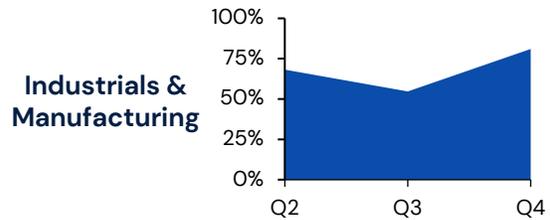
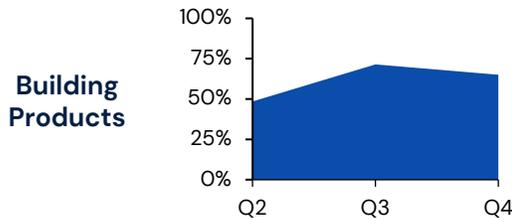
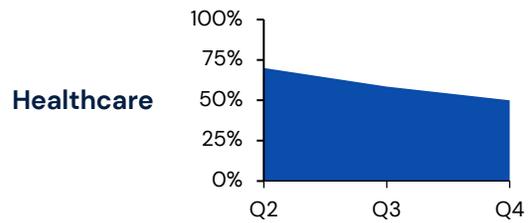
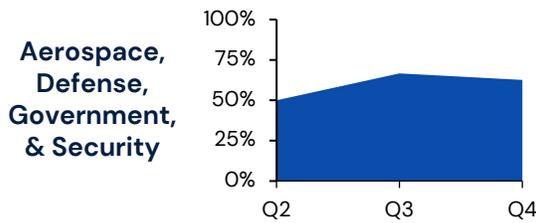
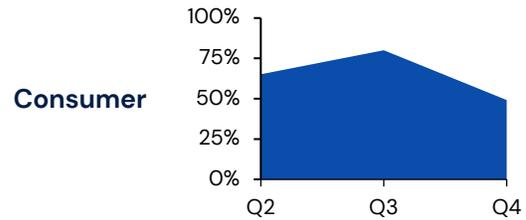
Question: How important will the following tactics be to your company over the next three months?
 Source: Capstone Partners' Middle Market Business Owner Survey, Sample Size (N): 430

03. Revenue Impacts, Forecasts, & Economic Outlook



Industrials Players with Revenue Gains Surge in Q4

The Industrials & Manufacturing industry experienced the greatest increase in respondents reporting revenue gains in Q4 (+26.3% QoQ). Fueled by substantial increases in new manufacturing orders and manufacturing prices, the industry is slated for continued revenue growth through 2022.

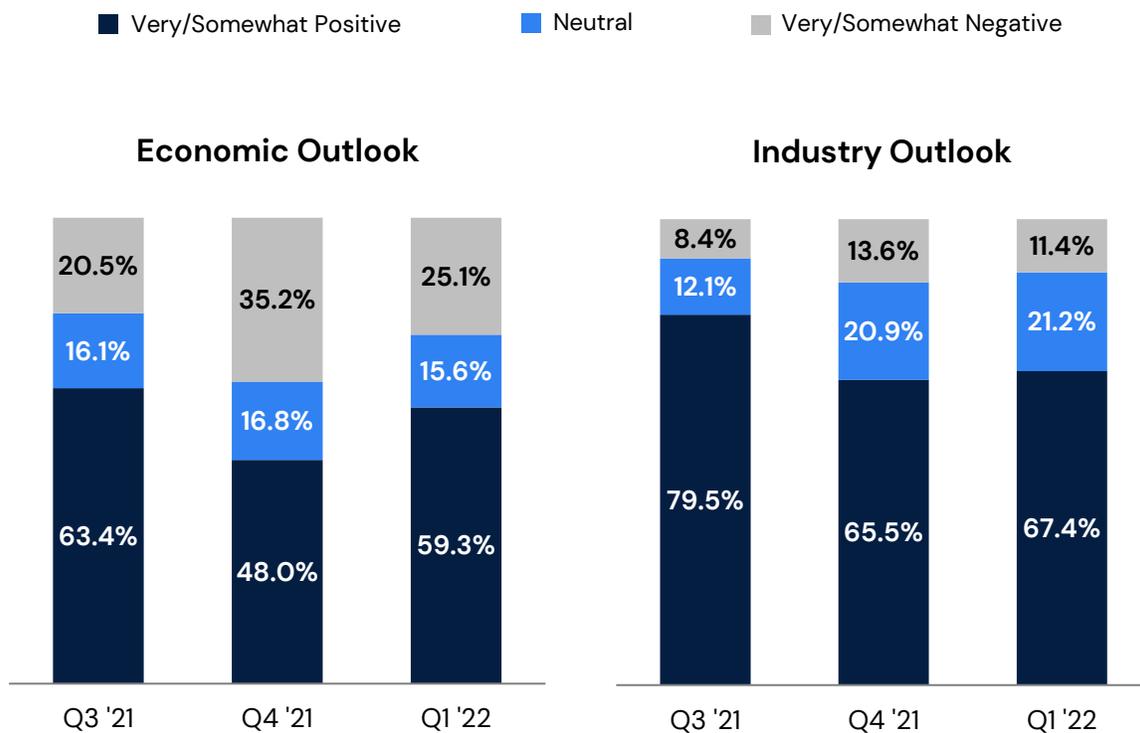


Question: Revenue increase over past three months
 Source: Capstone Partners' Middle Market Business Owner Survey, Total Sample Size (N): 380, 148, 430

CEO Confidence Up from Q4, Remains Below Q3 Levels

Economic optimism for Q1 increased by 11.3% compared to Q4, with 59.3% of CEOs feeling very or somewhat positive on the future state of the U.S. economy. This remains below Q3 levels with inflation running at a breakneck speed and rising corporate debt levels. Full economic recovery continues to be delayed by pandemic-induced issues including supply chain disruptions and labor shortages.

The sentiment business owners have expressed regarding their respective industries skews positive across all groups, with **more than two-thirds (67.4%) of CEOs somewhat or very positive on the outlook of their industry**. However, **industry optimism continued to trail Q3 levels**, likely driven by the widespread economic uncertainty faced in the prior quarter.

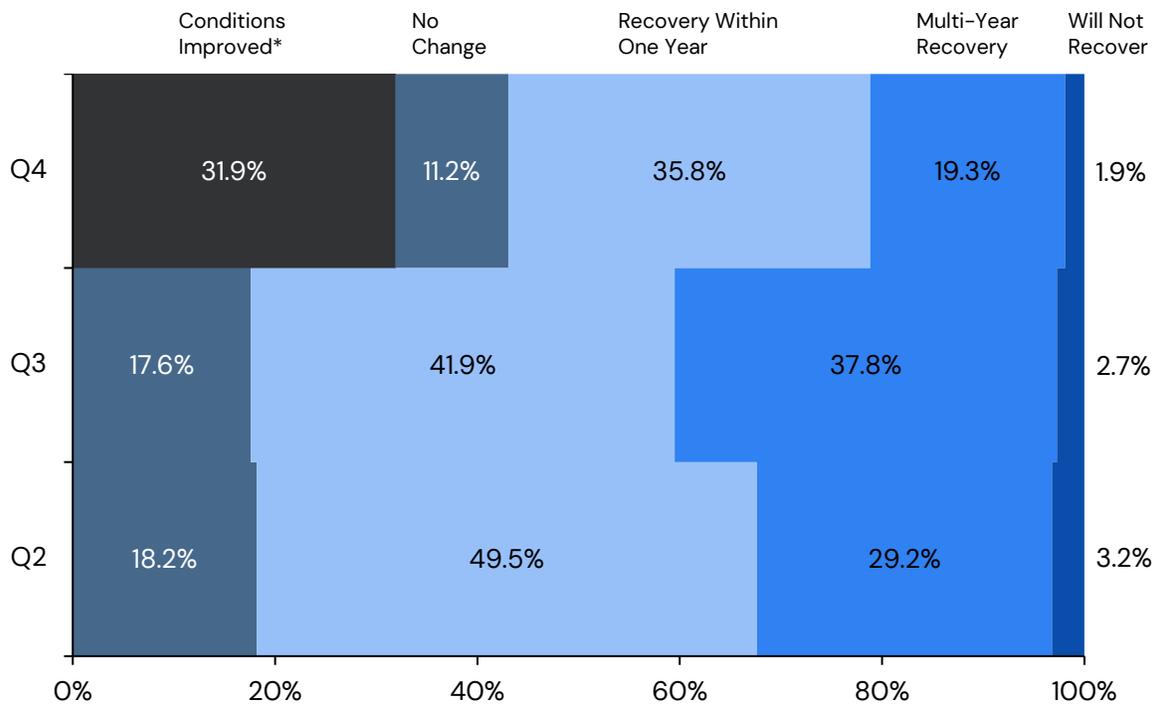


Question: Economic/industry outlook for the next three months?
 Source: Capstone Partners' Middle Market Business Owner Survey, Total Sample Size (N): 380, 148, 430

Business Condition Normalization in Sight

Middle market business owners' sentiment towards market conditions has improved in Q4, with those expecting a multi-year recovery declining by 18.5% QoQ. Respondents projecting business condition normalization within one year also declined compared to Q3 (-6.1% QoQ). **In Q4, nearly one-third (31.9%) of owners stated business conditions have improved, indicating a significant recovery in the middle market.** Notably, 48.3% of

respondents in the TMT industry affirmed that business conditions have improved, statistically higher than all other industries surveyed. While the TMT industry has exhibited a fair degree of defensibility against COVID-induced challenges, industry players have namely faced internal issues such as streamlining business processes (53.8%), adopting cloud infrastructure (30.8%), and transitioning to automated processes (30.8%).



*Option for Conditions Improved added in Q4 in response to survey participant requests
 Question: Within your industry, when do you expect conditions to return to pre-COVID-19 performance levels?
 Source: Capstone Partners' Middle Market Business Owner Survey, Sample Size (N): 380, 148, 430

About Capstone Partners

Capstone Partners is one of the largest and most active independently-owned investment banking firms in the United States. Over the past 20 years, thousands of business owners, investors, and creditors have trusted us to help guide their strategic decisions and maximize financial outcomes at every stage of the corporate lifecycle. For more information, please visit www.capstonepartners.com.

Built for the Middle Market

Capstone Partners has developed a full suite of corporate finance solutions, including M&A advisory, debt advisory, financial advisory, and equity capital financing to help privately owned businesses and private equity firms through each stage of the company's lifecycle, ranging from growth to an ultimate exit transaction.



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