2018 ANNUAL BUSINESS PRODUCTS AND SERVICES SPOTLIGHT
M&A trends and private equity deal activity
“Every incremental cost increase can have a material impact on a manufacturer’s profitability, so we expect manufacturers to continue to evaluate the value of labor and to reposition their focus on creating the most positive output for each dollar spent.”

Jason Alexander, Industrial Products Senior Analyst
Sentiment across the industrial products (IP) space remains stymied by macro-level uncertainties around trade policies and tariffs, which have evolved from a handful of products to include roughly 25 percent of all goods shipped from China. In turn, products shipped from the US have faced stiffening tariffs in China. These forces, combined with rising interest rates and a consequent increase in the costs of doing business, have introduced a level of uncertainty for manufacturers not seen in some time. By RSM’s estimation, rates at or above 3.5% could inhibit small and medium-sized businesses in the IP space from implementing countervailing solutions, including widespread adoption of automation to help them match revised profit expectations. Meanwhile, heightened valuations for those companies have contributed to a multi-quarter decline in M&A volume, now at its lowest level since 2013.
Manufacturers that have invested in technology, machinery, and equipment have benefited from bonus depreciation to drive capital expenditure. Although robotics and other forms of automation have created margin benefits across the manufacturing space, these developments could not keep the US automotive sector on a persistent growth trajectory. Rather, the auto sector has reached maturity in the US even as it steps up efforts to incorporate improvement in driving technology across the fleet. The automotive sector’s evolution into “mobility services” shines a spotlight on just how rapidly advances in commercial technology can drive wider changes in an industrial space. In addition, these forces have combined with urbanization and behavioral changes to begin shifting the nature of auto production. A trio of consequences from these developments emerged in Q4. General Motors, for instance, announced the elimination of five production facilities along with 14,000 jobs as it cuts smaller sedans from its product line. The automaker also announced in November that it will release a brand of electric bikes in 2019.
Financial and strategic investors will continue to confront unpredictability across the IP space for the foreseeable future. Not only will tensions around trade and tariffs remain persistent sources of uncertainty, interest rate increases appear poised to hinder some of the more ambitious plans to incorporate production improvements among manufacturers. Despite a persistent need to innovate while still being flush with cash, however, strategics have ceded ground to financial buyers of late. While rising wages have created a cautious sense of optimism around the overall state of the US economy, whispers of a recession are growing louder as growth in other corners of the globe continues to falter. A steadily increasing cost of labor in the US will make the need to incorporate automation at scale more urgent in the coming year.
DEAL FLOW CONTINUES TO SLOW

M&A transactions in B2B extended a multi-quarter decline in Q4, with the dip in overall volume reaching its lowest level in 5 years.

Deal making in commercial products, which comprise most manufacturing goods, dropped by 42 percent versus Q4 2017.

PE investors continue to show signs of reluctance, with deal counts down nearly 19 percent from Q3.

COMMERCIAL PRODUCTS INCREASE VALUE

The median M&A deal size in the B2B space recovered in a big way, climbing 51 percent over Q3 to top the peak reached for the past 5 years in Q2.

Transaction sizes by sector continue to vary: Commercial products gained 28 percent in aggregate value after falling to levels last quarter that were last seen in Q3 2016.

Commercial products deal volume dropped by 44 percent from the same period last year, reaching its lowest total since at least 2013.

STRATEGICS CEDE MORE GROUND TO PE BUYERS

PE buyers grabbed their greatest share of M&A activity in the B2B space for the past 5 years at 42 percent in Q4.

Add-on transactions hit a multiyear high as 2018 recorded 4 quarters at 50% OR MORE as a share of all completed deals for the first time over the past 5 years.

PE sellers continued shedding B2B assets to other financial sponsors rather than strategic buyers.
DEAL FLOW CONTINUES TO SLOW

M&A volume dropped once more in Q4, hitting its lowest level since 2013. Private equity (PE) investors continue to show signs of reluctance, with deal counts down nearly 19 percent from Q3. Overall, deal value fell by 20 percent compared to this time last year, while dealmaking in commercial products dropped by 40 percent in terms of volume. As recently as Q1, M&A activity surpassed 2,000 transactions. Dealmaking declined from Q3 by roughly 30 percent in both North America and Europe.
COMMERCIAL PRODUCTS INCREASE VALUE

With fewer but larger transactions taking place, the median M&A deal size in the B2B space recovered in a big way. Dealmakers helped median value to climb a staggering 77% in Q4 to top the peak of $42 million reached in Q2. While transaction sizes continue to vary from one sector to another, commercial products, which comprise most manufacturing goods, gained 28 percent in aggregate value after falling to levels last quarter that were last seen in Q3 2017.
PE buyers grabbed their greatest share of M&A activity in the B2B space of the past five years at more than 40 percent. Sponsored deals have steadily increased from roughly 30 percent since mid-2016. Meanwhile, add-on transactions, a clear favorite among dealmakers, hit a multi-year high as 2018 recorded four straight quarters at 50 percent or more as a share of all completed deals for the first time. PE sellers helped secondary buyouts surpass exits to strategics for the second straight year as corporate acquisitions for the year failed to top 400 transactions.
THE VALUE OF RSM’S MIDDLE-MARKET LEADERSHIP

Focusing on the middle market, RSM US provides integrated transaction advisory, tax, assurance and consulting services. Our work with 2,700 middle-market businesses and professional services companies gives us a deep understanding of the key trends impacting the industry. In addition, we have performed due diligence on more than 2,200 deals in the past five years, nearly 200 of which were business and professional services transactions. This in-depth knowledge provides our private equity and strategic buyer clients with industry-specific due diligence considerations.