2Q 2019 INDUSTRIAL PRODUCTS SPOTLIGHT
M&A trends and private equity deal activity
“There are good targets out there. It’s just harder to find them due to the competitive nature of the industry right now. As a result, sellers can dictate about how the process will go and what level of access prospective buyers will have much more than before.”

Hong Nguyen, Director, Transaction Advisory Services
US tariffs on $250 billion in goods shipped from China continue to weigh on dealmaking in the industrial products (IP) space, but secular factors have also contributed to the decline in deal volume of late. With the current economic recovery likely topping out in Q3 2018, trade policy has only added to an already competitive environment for investors targeting IP plays. However, some financial sponsors and strategic acquirers are struggling to get past the first round of increasingly crowded bidding processes even as more ambitious IP bets remain stalled until a clearer picture of the macro environment emerges. All the same, most manufacturers have arbitrated means to pass costs down the supply chain, depending on their industry and the arrangement they have with a customer. In some instances, the complete cost increases from tariffs have been passed onto the customer. Particularly in the automotive sector, clients serving one of the North American auto majors report that supplier arrangements with some original equipment manufacturers continue to prevent pass-through strategies from completely diluting their margins.
For investors targeting the IP space, the question of paramount focus is how long the US plans to pursue its current course on trade with China. Some investors—following one set of assumptions around tariffs—entered due diligence at the end of 2018 only to find that additional tranches of tariffs can significantly complicate the valuations process for some prospective targets in manufacturing. Deal closing times have slowed as a result, and many deals have been halted altogether, weighing on the volume of completed deals in the IP space through H1. “Some investors have found themselves in a difficult position because all of a sudden an important product got hit with new tariffs with a 10% to 15% impact on the target’s margins,” said Hong Nguyen, director of transaction advisory services for RSM. Meanwhile, some manufacturers have suffered a double-whammy impact, as the expanding set of tariffs hit both a product they buy and a product they sell. These developments complicate an environment in which it has become harder to achieve a full level of understanding about a target’s business operations, especially early in the review process, creating additional risks when submitting an initial bid.
Given the significant level of capital chasing fewer quality targets in the IP space, competition among investors for quality assets remains as stiff as ever, with some investors hunting for new assets and eventually reporting an inability to spend their money. According to Nguyen, tariffs have a more negative impact on the IP business, with few able to capitalize on the potential benefits touted by current trade policies. Investors thus far have often sought ways to mitigate the impact of US and China trade tensions on the operations of prospective targets during diligence. Transaction multiples should remain at historically elevated levels through H2, despite concerns about the macro environment. Consequently, clients can continue to expect multiple phases in completing a project, extending time to close as multiple parties are involved, which creates a lengthier and more constrained review process.
**M&A Activity Extends Its MultiQuarter Slide**

Completed deals and aggregate value both fell by about **40%** apiece YoY in Q2.

*40%*

M&A activity sustained deeper declines in North America at just **$33 billion** in value over 300 deals.

*33B*

Acquisitions in North America posted the lowest total in almost six years.

**Sponsor Activity Pulls Back Again But Posted Record Share of Overall Volume**

Accounting for some **45%** of all deals closed last quarter, PE continues to prop up weakening IP M&A activity.

*45%*

With **30** completed transactions, secondary buyouts held steady as a share of all exits.

**25%**

Strategic acquisitions of PE-backed companies have cooled considerably, accounting for only a quarter of last year’s total.

**Buy-and-Build Comes to IP**

Through the first half of 2019, financial sponsors have closed on **275** add-ons.

*50%*

Platform expansion via add-ons topped more than **50%** of all PE deals.

Positive change is coming for the buy-and-build strategy in the IP industry.
DEALMAKERS SIDELINED BY UNCERTAINTY AGAIN

Aggregate M&A value in manufacturing fell slightly in Q2 to $60 billion as overall volume posted its fifth consecutive quarterly decline, even as deal flow in Europe stabilized. Nevertheless, many dealmakers sizing up the IP space are postponing their acquisition strategies until an explicit picture of global trade emerges. Meanwhile, macro-level uncertainty may have started weighing on transaction sizes. Median deal size returned to a range last registered in Q1 2017 at some $26 million, representing a decline of more than 40% year over year (YoY).
PE UPS SHARE OF IP DEALS ON INCREASE IN ADD-ONS

Financial sponsors posted a record 60% share of overall IP M&A activity for Q2. Meanwhile, PE's buy-and-build strategy helped add-ons top half of all buyouts by count. This dynamic has contributed to the consistent tallies of PE deal flow in manufacturing through H1. However, at just $31 billion in aggregate value in Q2, financial sponsors committed about a quarter of the capital to the space relative to the same period last year, as the number of closed deals leveled off at a pace last seen in 2016.
Exit activity in the IP space returned mixed results in Q2, with financial sponsors selling portfolio companies to other PE firms rather than to strategics at a rate of roughly two-to-one. With just 14 deals closed, corporate acquisitions of PE-backed companies in manufacturing posted a dip of nearly 75% YoY. Meanwhile, financial sponsors have closed on half of last year’s total for IP take-privates en route to committing some $63 billion in aggregate across all transaction types.
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 3,600 industrial products companies gives us a deep understanding of the key trends impacting the industry. In addition, we have performed due diligence on nearly 2,600 deals in the past five years, 400 of which were industrial products transactions. This in-depth knowledge provides our private equity and strategic buyer clients with industry-specific due diligence considerations.

METHODOLOGY

M&A is defined as the substantive transfer of control or ownership. The data in this report tracks only completed control transactions. Announced, rumored or canceled deals are not included. Eligible transaction types include but are not limited to control acquisitions, leveraged buyouts (including asset acquisitions), add-on deals, corporate divestitures and reverse mergers. Volume will lag between quarters and will likely be revised upward once more data is collected, often resulting in more robust figures as the result of an ongoing research process to retroactively track down deals.