3Q 2019 INDUSTRIAL PRODUCTS SPOTLIGHT
M&A trends and private equity deal activity
“Tariffs continue to be the main concern of clients as they seek alternative solutions, whether moving their operations elsewhere or trying to renegotiate pricing with their customers or vendors to share the impact of tariffs.”

Hong Nguyen, Director, Transaction Advisory Services, RSM US LLP
The trade war between the United States and China continues largely unabated, despite recent progress on the first phase of a new deal. As a result, tariffs have become an even heavier weight on sentiment for deal-makers across the industrial products space in the third quarter. As RSM US LLP (RSM) observes in its latest edition of The Real Economy: Industry Outlook, that could be because the conflict more accurately represents an aggravating force—one exacerbating secular trends in line with late-cycle behavior across the manufacturing sector. Although many proactive clients have successfully developed strategies for passing on the costs to the enterprise created by the tariffs on Chinese goods over the past year, the subsequent slowdown in overall economic activity may prove too much to weather—particularly for those operating in the middle market—if additional duties take effect later this year. Manufacturers in this segment of the industry do not have the same resources for absorbing additional costs as their larger rivals. But financial sponsors have stepped in where possible to shore up some of that decline in overall investment activity this year and, at roughly $100 billion in aggregate value through the third quarter, private equity (PE) deal flow for Europe and North America has hardly represented a complete pullback of capital in the face of the sustained uncertainty.
The dispute between General Motors Corp. and United Auto Workers underscores the vulnerable position the U.S. automotive industry occupies as the trade war expands. The strike at its height cost GM an estimated $77 million per day in lost production. Meanwhile, citing figures from the automotive research website, Wards, RSM finds that auto sales have fallen slightly year over year, suggesting that demand has likely topped out and that the market for new vehicles will cool in the coming months. In addition, the decline within the automotive sector, combined with the existing threat from the Trump administration of a deeper trade dispute between the United States and Europe, could place additional tariffs on automotive imports. “Combined with the impact of the UAW strike, clients are increasingly concerned that these factors will exact a rolling impact on large automobile manufacturers,” explains Hong Nguyen, a director with RSM’s transaction advisory services. “In addition, commodity pricing and the impact of existing tariffs continue to put pressure on margins for companies within the automotive sectors—whether they are an OEM, a small-to-medium business or a large automotive manufacturer.” Declining profits across the automotive ecosystem will force automakers to reevaluate their investments, with ramifications for the entire supply chain at a time when softening demand and historically high prices on light trucks, the industry’s most popular vehicles, are already forcing manufacturers to improve efficiencies.
The headwinds for manufacturers created by U.S. trade policy have increased significantly over the past several quarters, as new rounds of tariffs continue to hit the IP space in successive waves. As a result, it is increasingly difficult for deal-makers to capitalize on the potential benefits from these policy changes. Pricing hikes and negotiations between vendors and customers have become more strained, for example. Meanwhile, the potential for additional tariffs on countries like Vietnam or Mexico, to which some have shifted operations to reduce exposure to China, looms. Clients expect more, not less, difficulty finding good assets going forward, while their ability to close deals for a reasonable price and within a reasonable timeframe is hamstrung by uncertainties. Concurrently, clients with the greatest level of international exposure will continue to seek assets in markets outside tariff-targeted zones. The potential slowdown in the global economy, created by trade tensions between the United States and China, will continue to characterize the conditions in which middle-market deal-makers buy and sell assets over the next 12 months. Middle-market clients are, therefore, more intrigued by the prospects of finding smaller add-on or proprietary assets rather than going through the full auction process.
MULTIQUARTER SLIDE IN M&A LEVELS OFF NEAR HISTORIC LOWS

The fewest number of deals were closed in Q3 since at least 2013, but aggregate value climbed more than 25% YOY.

SPONSOR ACTIVITY REMAINS ROBUST OVERALL

With PE behind more than 40% of all deals closed once again in Q3, financial sponsors continue to find value in the acquisition of IP assets.

ADD-ONS REPRESENT MORE THAN HALF OF ALL PE DEALS

PE firms continue to support buy-and-build strategies, with add-ons approaching 120 completed transactions in Q3.

The median transaction value doubled to a record $682 million, spurred by a relatively anemic completion rate.

$682M

Despite macro-level uncertainty in Europe, deal flow in North America continues to be resilient: 287 completed transactions and two-thirds of overall value.

Growth rounds remain on pace with historic performance levels.

25%

PE deal value remained flat in aggregate, while completed transactions declined by some 25% over the past quarter.

40%

Platform expansion via add-ons represented 53% of all PE deals last quarter, an increase of 6% over Q3 2018 results.

Three-quarters of the way through the year, financial sponsors have closed more than 430 add-on transactions, exceeding outright buyouts by some 20%.
M&A activity across manufacturing continues to contract, with completed transactions in the third quarter falling by 36% as overall volume dropped for a sixth straight quarter. However, the execution of several sizable deals in the space helped to push aggregate M&A value up quarter over quarter to provide the strongest quarterly finish of the year thus far at some $93 billion. As a result of deal-makers closing fewer but larger M&A transactions last quarter, the median deal size in the IP space hit an unprecedented level at $63.5 million—good for a doubling of that figure year over year.
Even as sentiment cools on the near-term prospects for the sector, financial sponsors across the middle market remain committed to the manufacturing space. In the third quarter, PE firms again backed over 40% of all M&A transactions completed. While overall M&A activity in IP contracted year over year last quarter, financial sponsors still posted a performance in line with historical levels at some 220 deals. Meanwhile, the industry’s preference for platform expansion via buy-and-build strategies helped add-ons to top 50% of all buyouts by count for a fourth straight quarter.
PE COMMITMENTS TO GROWTH EQUITY STILL STRONG

Not only have financial sponsors backed historically elevated levels of add-ons as an overall share of M&A activity over the past year, growth capital commitments on a deal-by-deal basis are still strong at more than 100 completed rounds through the third quarter. Although aggregate M&A activity is down across the IP space through the third quarter of 2019, the composition of deal flow by type across buyouts, add-ons, growth rounds and platform creation deals remain largely in line with historic levels across the capital committed by financial sponsors this year.
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.