Preparing for an upturn

M&A trends in industrial manufacturing

Q2’23

kpmg.com

Introduction

Deal makers are keeping their powder dry

Aside from isolated green shoots, IM deal activity in Q2’23 remained largely dormant, as unfavorable macroeconomic conditions, including elevated interest rates and inflation, persisted. Compared to Q1’23, the number of M&A transactions—as well as their overall value—declined significantly.

In contrast to Q1’23, Q2 had some private equity investors seizing opportunities. In general, corporate deal makers continued their pause.

On a subsector basis, aerospace and defense was buoyed by demand for commercial aircraft and new defense & space technologies. The single biggest transaction was Apollo Global Management’s $5.2 billion purchase of Arconic,[1] while Brookfield Infrastructure notched the largest corporate deal with its $4.7 billion acquisition of Triton International.[2]

It is still unclear what event(s) will give deal makers the confidence to unlock the log jam. We hear investors eagerly watching for more stability in interest rates, realigned seller value expectations and availability of the “right assets”.

Meanwhile, we see increasing activity in anticipation of a market upturn, with more businesses getting prepared for a sale. For most of our clients, maintaining deal discipline is paramount.

Todd Dubner
Principal
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Q2’23 highlights

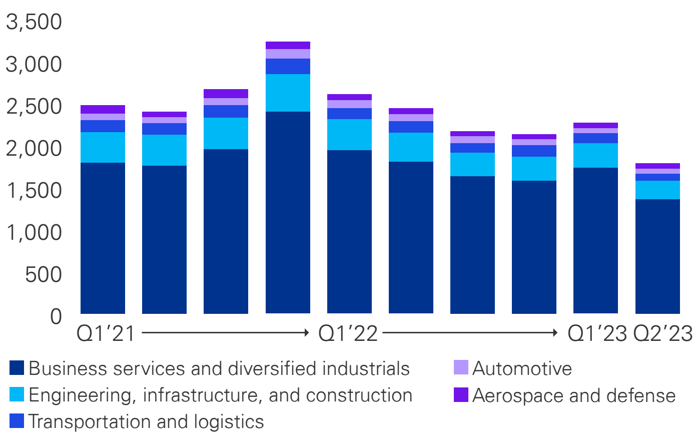
1,781 deals

▼ **21%** decrease QoQ

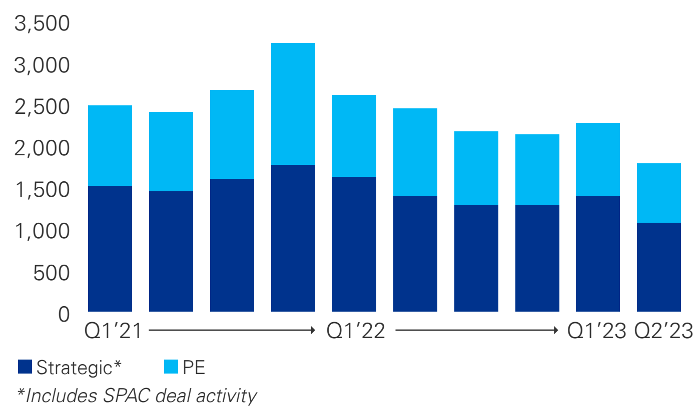
40% PE share of deals

▲ **1%** increase QoQ

IM deal activity by sector



IM deal activity by type



[1] Arconic, “Arconic to Be Acquired by Apollo Funds,” May 4, 2023
[2] Triton, “Brookfield Infrastructure Transaction,” April 2023

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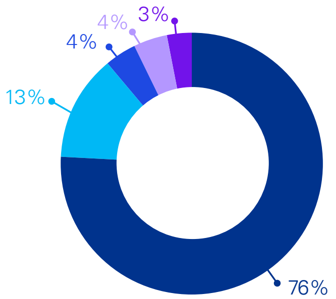
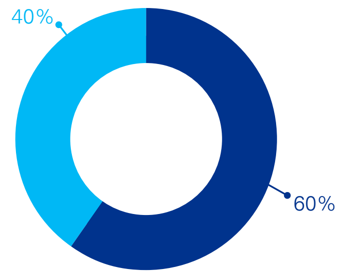
Q2’23 deal mix

Sector mix



PE/strategic mix



Top strategic deals

Acquirer	Target	Value (billions)
Brookfield Infrastructure	Triton International	$4.7
Allkem	Livent	$3.8
HEICO Corporation	Wencor Group	$2.1

Top PE deals

Acquirer	Target	Value (billions)
Apollo Global Management	Arconic	$5.2
Kohlberg Kravis Roberts	CIRCOR International	$1.6
Morgan Stanley Infrastructure	Valoriza Servicios Medioambientales	$0.8

Deal data has been sourced from Capital IQ, Pitchbook, and KPMG analysis and excludes asset purchases/minority purchases. Q2 2023 covers all US deals announced from April 1, 2023 to June 30, 2023. Deal values are presented based on publicly available deal data and might not be exhaustive. Previously published statistics may be restated to incorporate new data and/or any changes.

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At a glance

Aerospace and defense

Maintenance and repair deals keep the sector aloft

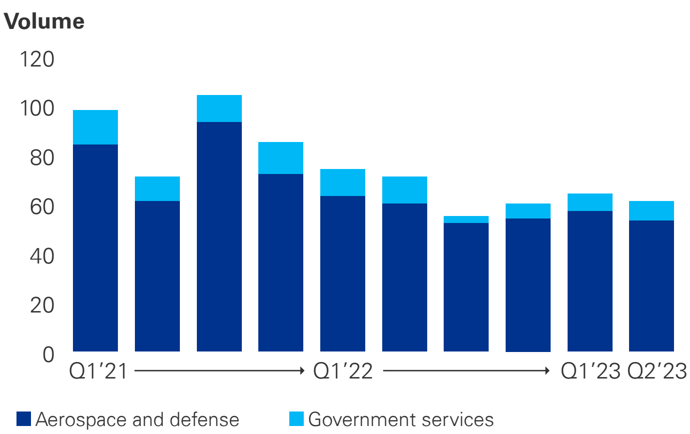
In aerospace and defense, both strategic and PE buyers continue to go after technology services and aftermarket/maintenance businesses. Operating in a sector running countercyclical to the broader economy and in an environment of record passenger travel, they target businesses with technologies that insulate them from supply chain challenges. In addition, they are striving to improve their position in the Department of Defense budgets for cybersecurity, hypersonic aircraft, unmanned vehicles, and space, among others.

The total number of deals remained roughly the same. PE accounted for a larger share of that volume, from 28.1 percent in Q1 to 31.1 percent in Q2. The top deal was HEICO Corp.'s $2 billion acquisition of Wencor Group, which was aimed at increasing HEICO's portfolio of generic parts makers. Similarly, Oshkosh Corp. added JBT AeroTech to expand its offerings of aftermarket parts and services, and Barnes Aerospace bought MB Aerospace Holdings, which makes and services aircraft engine components.

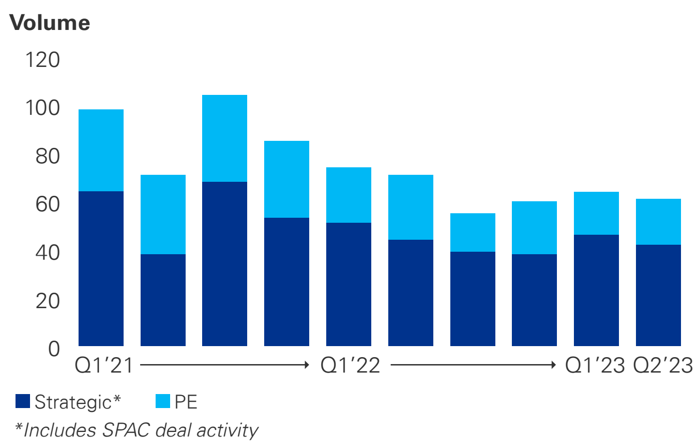
Q2'23 highlights

61 deals ▼ **5%** decrease QoQ | **31%** PE share of deals ▲ **3%** increase QoQ

A&D deal activity by subsector



A&D deal activity by type



On HEICO Corporation – Wencor Group deal:

"The Wencor acquisition materially expands HEICO's aftermarket product offerings, enabling the combined company to offer even greater savings and capabilities to its customers while expanding our new products and services development capacity."

—Laurans Mendelson, Chairman and CEO, HEICO Corporation

On Aliaxis – Valencia Pipe Company EIC deal:

"This transaction supports our 'Innovate. Serve. Advance.' business strategy as we enter the attractive air transportation support space with a market-leading portfolio of purpose-built products and comprehensive service offerings."

— John Pfeifer, President and CEO, Oshkosh Corporation

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> **On Barnes Aerospace –MB Aerospace Holdings deal:**
>
> "MB is an exceptional strategic fit for us with highly complementary program focus, global operations, technical capabilities, and product offerings."
>
> *—Thomas J. Hook, President and CEO, Barnes Aerospace*

Top A&D deals

Acquirer	Target	Rationale	Value (billions)
HEICO Corporation	Wencor Group	Expand product offerings	$2.1
Oshkosh Corporation	JBT AeroTech	Enter new market	$0.8
Barnes Aerospace	MB Aerospace Holdings	Enhance technical capabilities and product offerings	$0.7

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> "We are seeing supply chain disruptions in both commercial aviation and the defense industry due to continued workforce shortages as well as discontinued disentanglement from China/Russia. We'd expect A&D companies to utilize M&A as one of the tools to help mitigate these challenges."
>
> *—Andrew Kersse, KPMG Partner*

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At a glance

Automotive

EV dealmakers drive below the speed limit

M&A activity in the automotive sector continued decelerating in Q2—the number of deals declined by 35.3 percent from Q1’23.

Bannix Acquisition announced a $500 million SPAC merger with Evie Autonomous, a maker of autonomous, adaptable, electric shuttle pods. And Ontario-based Linamar Corp. bought the EV Battery Enclosures business of DURA Automotive Systems for $300 million—an example of the current appetite in the sector for component makers.

Q2’23 highlights

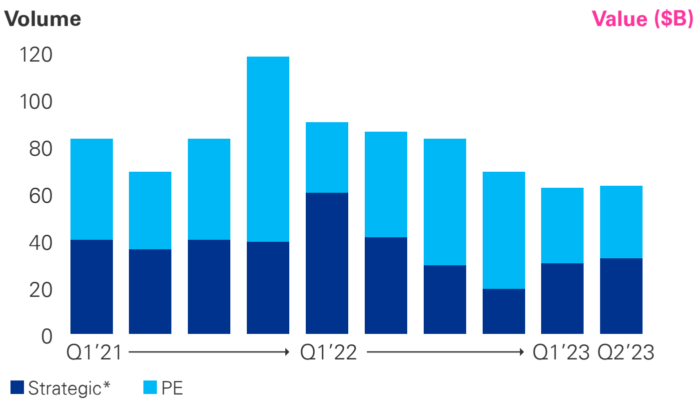
63 deals

▲ **2%** increase QoQ

49% PE share of deals

▼ **2%** decrease QoQ

Automotive deal activity by type



Includes SPAC deal activity

Top automotive deals

Acquirer	Target	Rationale	Value (billions)
Bannix Acquisition Corp.	Evie Autonomous	SPAC merger	$0.5
Linamar Corporation	Battery enclosures business of Dura-Shiloh	Expand electrification portfolio	$0.3

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At a glance

Engineering, infrastructure, and construction

A slumping sector watches and waits

In Q2’23, the engineering, infrastructure, and construction (EIC) sector showed considerably fewer transactions than in Q1’23 for both strategic and private equity dealmakers, for an overall decline of 23.4 percent. PE investors increased their share of activity in relation to that of corporate deals.

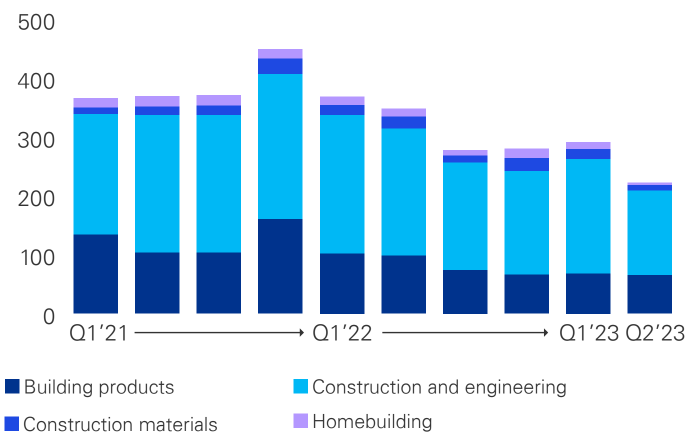
There were also fewer transactions across all subsectors. That weakness continues to reflect the high interest rates, tight labor market, and supply chain disruptions plaguing the industry.

The top deal in the quarter was Platinum Equity’s $460.5 million acquisition of JELD-WEN Australia, a manufacturer and distributor of windows and doors throughout Australasia, which expands the PE firm’s building products portfolio in the region. Belgium’s Aliaxis acquired the manufacturing division of Valencia Pipe for $300 million, giving it a presence in the western U.S.

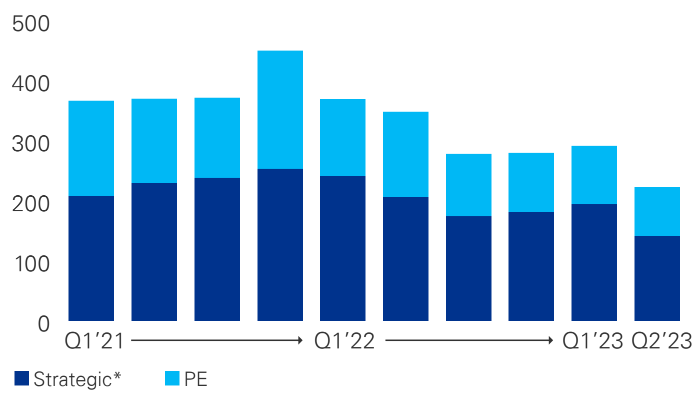
Q2’23 highlights

222 deals ▼ **24%** decrease QoQ | **36%** PE share of deals ▲ **3%** increase QoQ

EIC deal activity by subsector



EIC deal activity by type



*Includes SPAC deal activity

On Platinum Equity – JELD-WEN Australia deal:

“JELD-WEN has built an impressive business in Australia, with well-recognized brands and a long legacy of manufacturing high-quality products.”

—Adam Cooper, Managing Director, Platinum Equity

On Aliaxis – Valencia Pipe Company EIC deal:

“This acquisition provides us with an excellent opportunity to expand our reach into the western United States to enter new markets and be the partner of choice for our national customers.”

—Alex Mestres, Divisional CEO Americas, Aliaxis

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Top EIC deals

Acquirer	Target	Rationale	Value (billions)
Morgan Stanley Infrastructure	Valoriza Servicios Medioambientales	Not disclosed	$0.6
Platinum Equity	JELD-WEN Australia	Customer brand recognition	$0.5
Aliaxis	Valencia Pipe Company manufacturing division	Expand geographic market (western United States)	$0.3

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"Drivers for M&A activity in Q2 included rightsizing the product portfolio and, for E&C M&A particularly, geographic infill given the fragmented nature of the construction market."

—Serena Crivellaro, KPMG Managing Director

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At a glance

Transportation and logistics
Deal making stalls

In Q2’23, transportation and logistics M&A transactions fell off a cliff. A notable difference this quarter compared with Q1 was in the mix of strategic and PE deals. In Q2, private equity largely retreated from the field.

While logistics companies have yet to embark on a broad decarbonization program, several route businesses (and middle mile) are beginning to make investments in EV trucks.

The major deal of the quarter was Tennessee-based Covenant Logistics Group’s acquisition of Lew Thompson & Son Trucking, an Arkansas-based poultry carrier, for $100 million. Covenant believes the business will act as as a cushion against economic cycles.

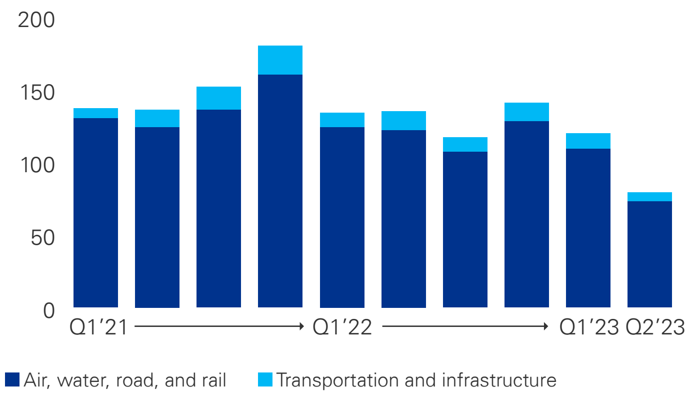
> “Opportunistic corporates are trying to capitalize on the inflection point in value. We expect the T&L sector, largely 3PL and 4PL providers, to have a significant consolidation wave once valuations and outlook are reset, but it’s still early.”
>
> *—Scott Heery, KPMG Partner*

Q2’23 highlights

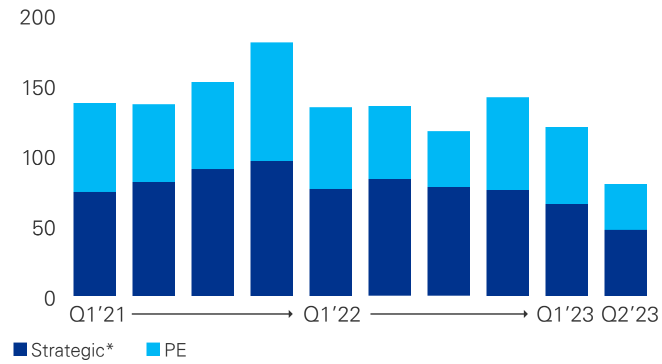
79 deals ▼ **34%** decrease QoQ

41% PE share of deals ▼ **5%** decrease QoQ

T&L deal activity by subsector



T&L deal activity by type



*Includes SPAC deal activity

Top transportation and logistics deals

Acquirer	Target	Rationale	Value (billions)
Covenant Logistics Group	Lew Thompson & Son Trucking	Niche market with less sensitivity to economic cycles	$0.1

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> **On Covenant Logistics Group – Lew Thomson & Son Trucking deal:**
>
> “We pursued Lew Thompson & Son because of their proven track record of operating a first-class, dedicated contract carrier business in a niche market, which we believe has less sensitivity to economic cycles and opportunities to grow.”
>
> *—David Parker, Chairman and CEO, Covenant Logistics Group*

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Deep dive

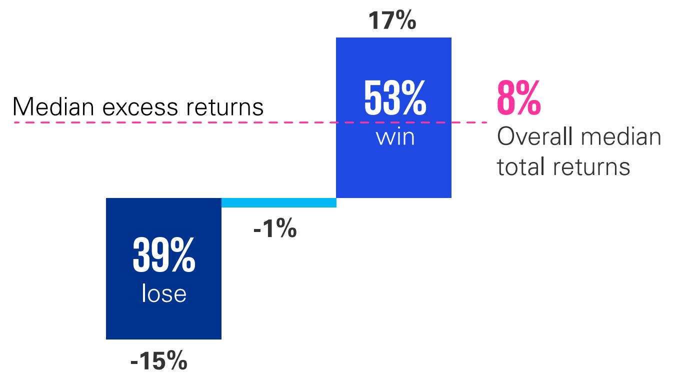
Think before you spin

Over the past five years, KPMG has developed a body of research we call Active Portfolio Management as a strategy for increasing the value of a portfolio of businesses. This research has demonstrated the benefits of strategic portfolio trimming—for example, divesting assets with disparate financial characteristics that drag down market value.

Among the options for divestiture strategists can consider an outright sale or a spin-off. Because spin-offs create two publicly traded entities—the remaining company and the spin—they provide a unique opportunity to track the value created (or destroyed) and the factors that determine success. Our study of 117 such spin-offs has uncovered patterns that lead to relative success or failure of such transactions. This proprietary research supports our view that divesting is an underappreciated way to create value. We have also come to understand why not all spin-offs are equal in the value they create—the devil is definitely in the details.

Our research establishes that only about half of spin-offs beat the benchmark for shareholder return and that most of the rest actually underperform the market. Beneath those numbers lie important distinctions: Some of the benchmark beaters in the spin-off transactions we studied created excess value for shareholders of both the parent and the spin-off—call those win-wins. Of the transactions that underperformed the market, a third were lose-lose—that is, the transaction destroyed value for both the remaining company and the spin-off.

Exhibit 1: About 40 percent of spinoffs generate below-market returns



Note: (1) Methodology: To evaluate total return, we tracked one share of stock 13-days pre-spin through spin until one year after execution. We included any dividends received and then annualized the return, accounting for changes in the ParentCo and SpinCo share price and the timing of dividends. We then compared to a similarly constructed composite of XAX, IXIC, and NYA; Market performance was +/- 3% total excess returns; (2) Sample size: Beginning with 117 deals in our spin-offs database, we further reduced the sample as follows: (a) 25 deals were excluded because the Spinco was not trading 1 year after spin, (b) 14 were multi-way splits, (c) 17 deals did not yet have 12 months of data post spin execution; (d) 4 due to date inconsistency across databases; (e) 5 due to return inconsistency compared to parent returns; 52 deals were included in this analysis

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How to create a win-win spin

We isolated seven characteristics and conditions that are associated with win-win outcomes and create distinctive investment theses for both the remaining company and the spin-off.

1. **Consider preserving the value chain.**
Almost half of lose-lose deals broke the value chain, e.g., a vertically integrated manufacturer that spins off a robust distribution business has to find a third-party distributor, while the spun off distributor is left searching for new manufacturing parties.

2. **Enable new capital allocation priorities.**
Almost all win-win spin-offs included a specific goal by the spin-off to seek a larger allocation of capital and plans to invest in promising, previously underfunded projects.

3. **Build distinctive investment theses for the remaining company and the spin-off.**
Target different investor bases, define distinctive end markets, or structure different revenue models to give investors a clear thesis for investing.

4. **Spin a business with a disparate financial profile.**
Divesting businesses with disparate financial characteristics (growth rates, margins, asset/capital intensity) can unlock value.

5. **Leave the spin-off with a clean balance sheet.**
Loading debt onto the spin-off can backfire and generate total negative returns for the parent.

6. **Bigger is better.**
The chances of success increase with size, both of the parent and the spin-off, as sufficient resources presage better performance and thus excess returns.

7. **Volatile times may be good times to divest.**
Counterintuitively, our research showed that spin-offs during a period of economic upheaval and uncertainty delivered a premium.

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Outlook

M&A activity will continue in low gear until inflation is tamed

Competing dynamics will determine the level of M&A activity in the IM sector as 2023 progresses. With the slowdown in M&A activity since Q3'22 and the persistence of the macroeconomic and political uncertainties, strategic and PE deal makers are still trying to find strategic acquisitions. Competitive and market pressures are driving companies to accelerate their inorganic growth plans, with many considering collaborations that help them automate operations or otherwise improve performance. However, although some companies may have plenty of cash on hand, deal makers—other than possibly automotive and aerospace and defense—will likely still be cooling their heels through the rest of this year. Economists anticipate a slowdown in late 2023 and early 2024.

We believe this hesitancy is well-founded. KPMG Economics anticipates two additional rate hikes in the second half of 2023. Cash reserves may insulate large strategic buyers from the need to add leverage at high interest rates; however, smaller buy-side deal makers face tighter lending restrictions from banks.

Both buyers and sellers are constrained, not just by multiple lingering uncertainties but also by the lack of quality deals and financing markets. However, quality companies continue to receive strong valuations, and we expect smaller processes or off-market deals.

Most companies remain in "watch and learn" mode. Sentiment among KPMG clients, both corporate and PE, suggests that a resumption of deal activity is likely in the next 3 to 6 months. Companies have used the dealmaking pause to reassess their assets and portfolios. Strategic M&A professionals considered targets that could strengthen their supply chains or give them a competitive advantage by helping reshape their businesses to achieve automation, AI, and sustainability goals. Exceptions include automotive companies, which are scrambling to find partnerships and deals to ensure precious mineral supplies for EV batteries, and A&D companies, which are driven by aftermarket/supply chain needs and Department of Defense budget priorities for advanced technologies.

At the same time, corporate and PE firms are eyeing strategic divestitures, accelerating performance improvement efforts, and preparing assets for sale. Companies generally know what they would like to sell, but unless they need to—for instance, to finance a purchase—they are still holding on.

The stalled processes from H2'22 are starting to get dusted off. We expect more spin-offs of high-value businesses that no longer fit the parent's direction. Similarly, we anticipate that PE firms will rebalance portfolios and sell assets that have reached the end of their lifecycle. Deal makers, while not really running full processes, will return to areas of high interest and try to align on value.

Key considerations

1 Be prepared

"Waiting it out" is not always viable. Consider opportunities to sell at high valuations when there is a strong strategic rationale for the buyer in both cost and revenue synergies.

2 Be creative

Find ways to optimize your assets to better effectuate your strategic plan through joint ventures, divestitures, or consolidation at lower tiers.

3 Be disciplined

Prepare for M&A activity to resume by developing plans and initiating performance improvement activities that boost sale value. Buyers: Emphasize the diligence fundamentals and ensure data-based projections. Sellers: Be more rigorous with projects and assumptions.

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How we can help you

KPMG helps its clients overcome deal obstacles by taking a truly integrated approach to delivering value and leveraging its depth in the IM industry, data-supported and tools-led insights, and full M&A capabilities across the deal lifecycle.

With an IM specialization, our teams bring both transactional and operational experience, delivering rapid results and value creation.

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