On the edge of an upturn

M&A trends in industrial manufacturing

Q1'23

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Introduction

Upturn on the horizon

The continued downward trend in IM deal volume and value in Q1 2023 reflects the underlying economic conditions, with interest rates remaining high and inflation falling but still elevated. Compared to the last quarter of 2022, total M&A volume dropped by 25 percent and value cratered by a massive 62 percent.

Amid concerns over the forecastability of long-term earnings and cost of debt, financial buyers retreated, with PE responsible for just 36 percent of deals and 20 percent of value.

All primary subsectors experienced a decline in volume, with transportation and logistics the hardest hit—down by 47 percent from Q4 2022. And in terms of value, the drop was even steeper. The single biggest transaction was Apollo Fund's $8.1 billion capture of Univar Solutions, while the largest corporate deal saw National Instruments snapped up by Emerson Electric for $7.6 billion.

Given the current market volatility, investors are holding back from committing to transactions. However, there is plenty of sell-side preparation in anticipation of an upturn, with many companies eager to divest nonstrategic assets. We can hopefully expect an explosion of deals once conditions become more favorable in the second half of the year.

Todd Dubner
Principal
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Q1'23 highlights

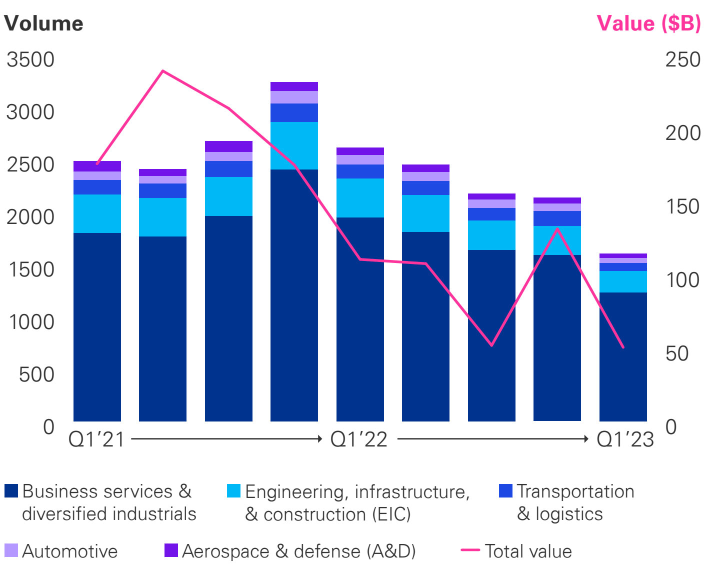
1,597 Deals

▼ 25% Decrease QoQ

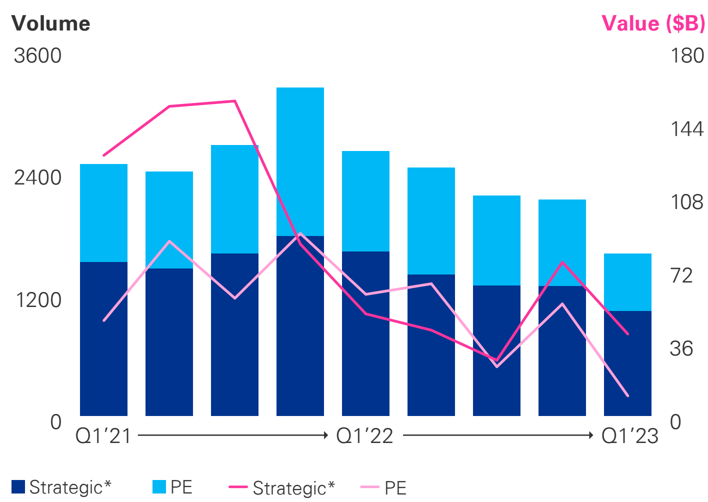
$50.2 Billion deal value

▼ 62% Decrease QoQ

IM deal activity by sector



IM deal activity by type

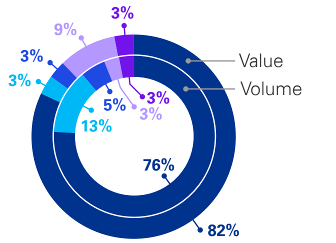


*Includes SPAC deal activity

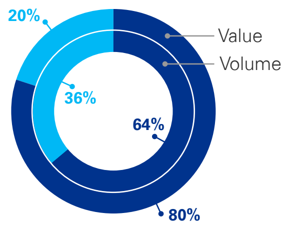
Q1'23 deal mix

Outer ring represents value. Inner ring represents volume.

Sector mix

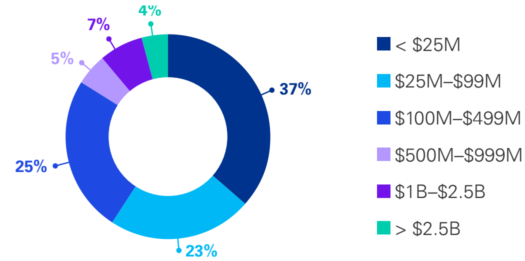


PE/Strategic mix



*Includes SPAC deal activity

Value size mix



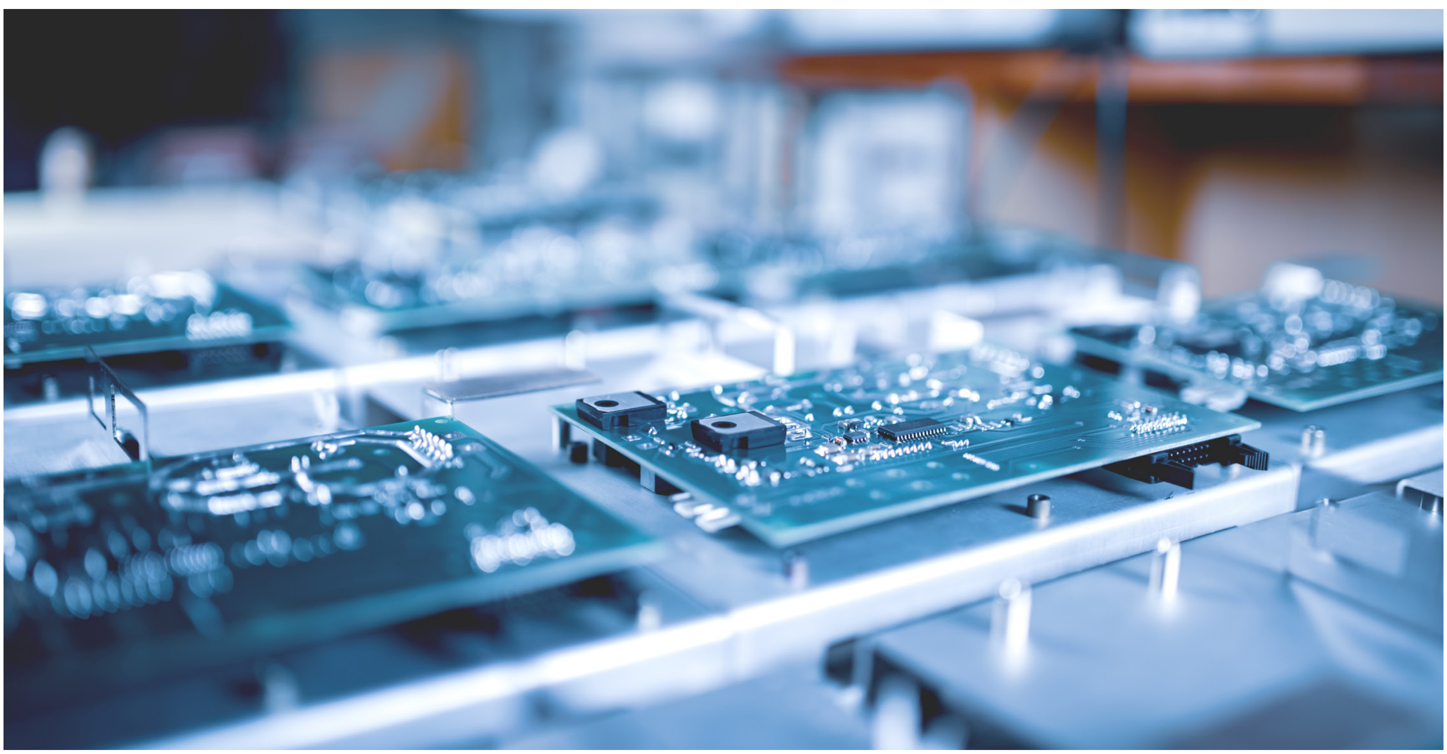
Top strategic deals

Acquirer	Target	Value (billions)
Emerson Electric	National Instruments	$7.6
Xylem	Evoqua Water Technologies	$7.5
Concentrix Corporation	Webhelp	$4.8
LKQ Corporation	Uni-Select	$2.1
BP Products North America	TravelCenters of America	$1.3

Top PE deals

Acquirer	Target	Value (billions)
Apollo Global Management	Univar Solutions	$8.1
GI Partners	Atlas Technical Consultants	$1.1
TPG	Asia Pacific Education	$0.3
Riverstone Holdings, Inclusive Capital Partners	Enviva	$0.2

Data was sourced from Capital IQ, Refinitiv, Pitchbook, and KPMG analysis. The values and volumes data cited are for U.S. deals announced between 1/1/2023 and 3/10/2023. Deal values are only presented based on publicly available deal data and are not exhaustive. Previously published statistics may be restated to incorporate new data and/or changes in deal volumes.



At a glance

Automotive

EV revolution remains the driving force

After a very steady 2022, the automotive sector experienced the chilling winds of uncertain economic growth in the first quarter of 2023. The number of deals was down by 30 percent, and the total value fell by 64 percent from Q4 2022.

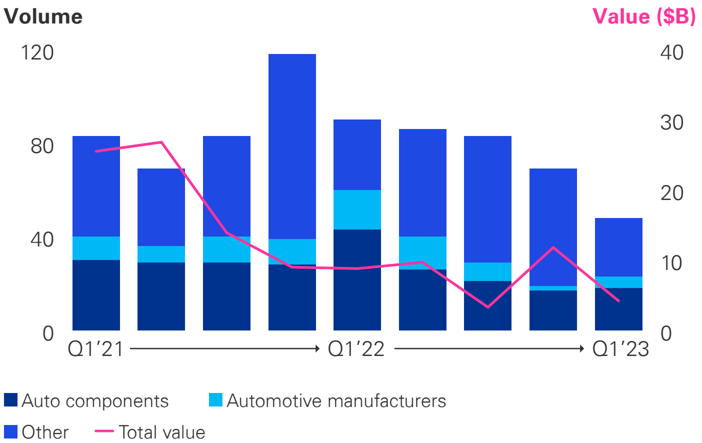
BP's $1.3 billion purchase of truck stop chain Travel Centers of America is indicative of the scramble for EV charging real estate, to take advantage of federal infrastructure stimuli. Expect considerable activity in this space over the next six to nine months, including from OEMs, which acknowledge that charging networks are key to EV growth.

Q1'23 highlights

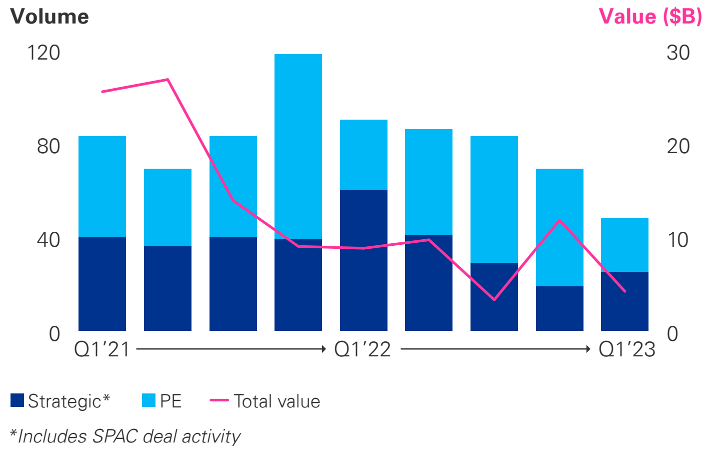
48 Deals ▼ **30%** Decrease QoQ

$4.2 Billion deal value ▼ **64%** Decrease QoQ

Automotive deal activity by subsector



Automotive deal activity by type



Includes SPAC deal activity

Top automotive deals

Acquirer	Target	Rationale	Value (billions)
LKQ Corporation	Uni-Select	Market penetration, geographic penetration	$2.1
BP Products North America	TravelCenters of America	Market penetration, scale business	$1.3
EF Hutton Acquisition Corporation I	E.C.D. Auto Design	SPAC transaction	$0.2
Cummins Inc.	Faurecia's commercial vehicle exhaust business	Not disclosed	$0.2
Fox Factory	Custom Wheel House	Broaden product offering	$0.1

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At a glance

Aerospace and defense

Signs of M&A recovery emerging

With no mega-deals—the largest transaction of the quarter was AIRO Group's merger with SPAC Kernel Group for just $0.8 billion—total deal value plummeted by 89 percent, despite volume only 25 percent lower than the previous quarter. Strategic buyers continued to account for approximately two-thirds of transactions by number—and almost 100 percent by value.

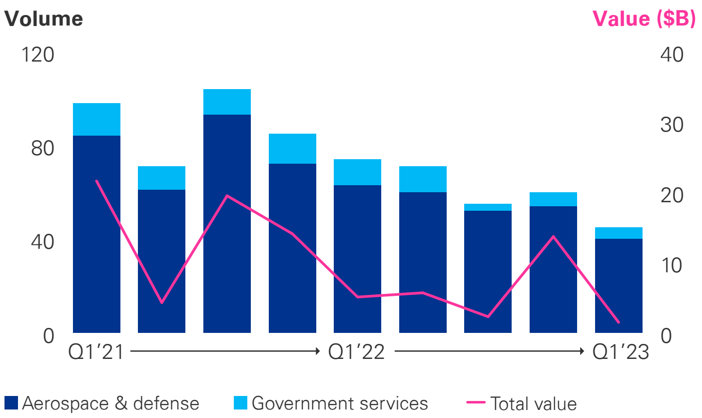
Activity is expected to pick up in the second half of 2023. This activity will be driven by consolidation of capital-constrained lower-tier suppliers, especially in highly fragmented segments; vertical integration of strategically critical vendors; a rebound in the aftermarket/maintenance, repair, and operations (MRO) segment; and increased funding directed to replenishing ammunition and armaments and in technology to reduce lead times related to the Ukraine conflict and high-growth segments, including space, and command, control, computers, communications, cyber, intelligence, surveillance, and reconnaissance (C5ISR).

Q1'23 highlights

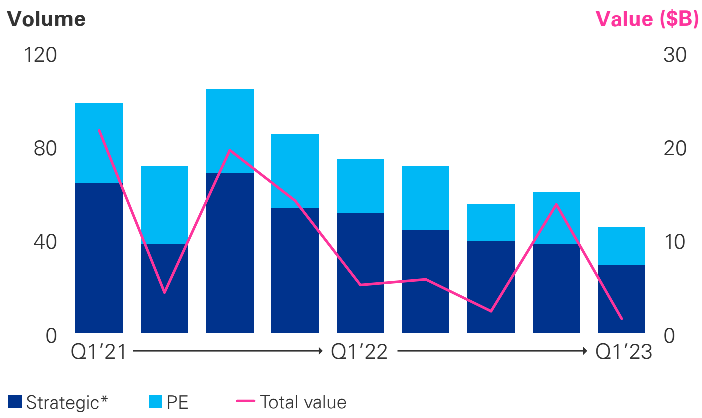
45 Deals ▼ **25%** Decrease QoQ

$1.5 Billion deal value ▼ **89%** Decrease QoQ

A&D deal activity by subsector



A&D activity by type



*Includes SPAC deal activity

Top aerospace and defense deals

Acquirer	Target	Rationale	Value (billions)
Kernel Group Holdings	The Airo Group	SPAC transaction	$0.8
Leo Holdings Corp. II	World View	SPAC transaction	$0.1

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At a glance

Engineering, infrastructure, and construction

Deals can accelerate infrastructure revolution

After a sudden spike towards the end of 2022, the EIC sector has seen deal value plunge by 92 percent to $1.7 billion–which pales against the $30.8 billion in Q1 2022. Nevertheless, hopes are high for M&A in the wake of government infrastructure stimuli.

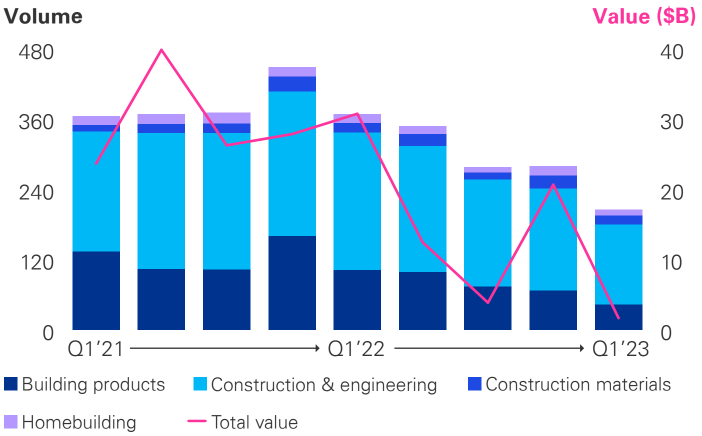
However, the tight labor market poses a real challenge to fulfilling the demand generated by the Infrastructure Investment and Jobs Act (IIJA), the Inflation Reduction Act (IRA), and the Creating Helpful Incentives to Produce Semiconductors (CHIPS) and Science Act, slowing down permiting, pushing up prices, and delaying projects. In a bid to help match an overwhelming demand with labor (and to lesser degree, materials) shortages, we expect an increase in investments in labor-saving technologies, rebalancing to project portfolios, as well as JVs/partnerships and collaborations to execute on larger projects.

Q1’23 highlights

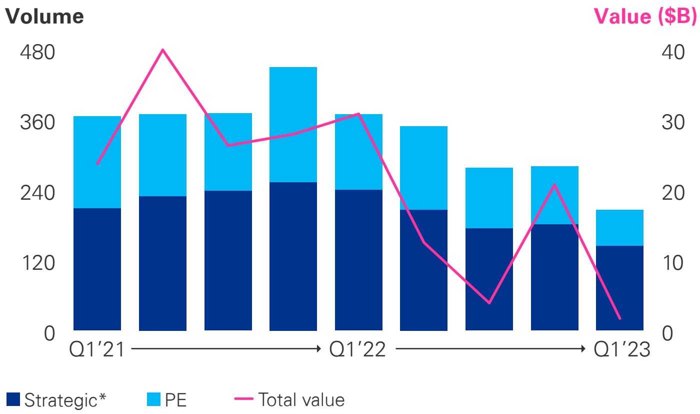
206 Deals ▼ **26%** Decrease QoQ

$1.7 Billion deal value ▼ **92%** Decrease QoQ

EIC deal activity by subsector



EIC activity by type



*Includes SPAC deal activity

Top engineering, infrastructure, and construction deals

Acquirer	Target	Rationale	Value (billions)
Holcim	Duro-Last	Strengthen sustainability, increase operational capabilities	$1.3
Jaguar Global Growth Corporation I	GLAAM	SPAC transaction	$0.2

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At a glance

Transportation and logistics

Technology and decarbonization create deal opportunities

Having held steady throughout 2022, deal volume almost halved in Q1 2023, while value fell by 83 percent to just $1.6 billion. PE buyers comprised more than 40 percent of deals, but a very small proportion of total value.

The second half of the year brings optimism for large deals that may have stalled in the past six to nine months, as funding conditions improve, and sellers become impatient to release assets. Technology is likely to be a further driver of M&A, to bring efficiencies that counter labor shortages and increase competitive advantage. As logistics companies begin to transition to carbon-neutral, expect investments in electric fleets, alternative fuels, and decarbonization of facilities.

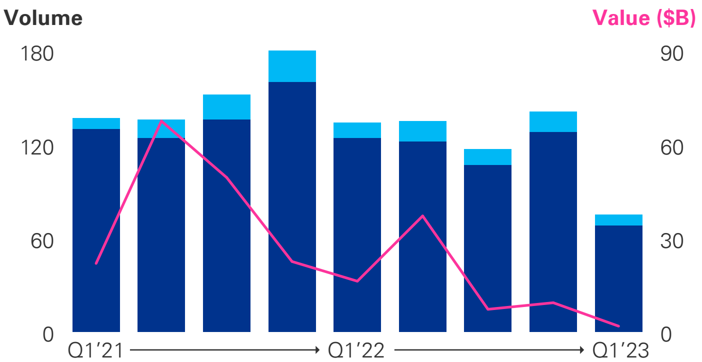
This may be a long-term macro trend that impacts trends in the future, but demand from shippers to maintain and increase inventory levels is still low given economic uncertainty.

Q1'23 highlights

75 Deals ▼ **47%** Decrease QoQ

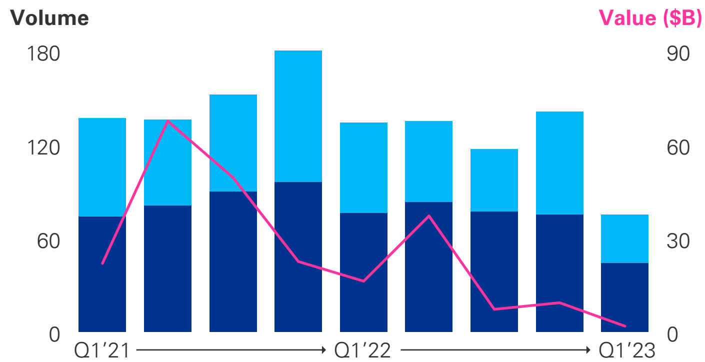
$1.6 Billion deal value ▼ **83%** Decrease QoQ

T&L deal activity by subsector



■ Air, water, road & rail ■ Transportation infrastructure — Total value

T&L deal activity by type



■ Strategic* ■ PE — Total value

Includes SPAC deal activity

Top transportation and logistics deals

Acquirer	Target	Rationale	Value (billions)
Knight-Swift Transportation Holdings	U.S. Xpress Enterprises	Economies of scale, limited opportunities for organic growth	$0.8
Port of South Louisiana	Avondale Global Gateway facility	Strengthen sustainability opportunities	$0.4
Campbell Transportation	Marine assets of NGL Marine	Diversify offerings	$0.1
Trinity Industries	RSI Logistics	Diversify service offerings, strengthen technology	$0.1
Forward Air Corporation	Land Air Express' assets	Expand geographic footprint	$0.1

Data was sourced from Capital IQ, Dacis, and company reports.

Deep dive

Buyers search for greater certainty

The last couple of years have been something of a rollercoaster ride for aerospace and defense (A&D) M&A. And that volatility is set to continue through 2023 due to the continuing conflict in Ukraine, inflation, high energy and commodity prices, and supply chain disruption.

A stellar 2021 saw a significant rebound in deal activity, as pent-up demand was unleashed following the relaxation of pandemic restrictions. Some companies sought to reshape their portfolios to seize growth opportunities or improve resilience to future downturns, while others needed to raise cash quickly to restore liquidity. Several deals were pulled forward to avoid rising cost of capital and potential tax increases.

The positive M&A climate was further fueled by a number of factors. These included favorable regulations, stimuli that eased financing, low interest rates, an unprecedented number of SPAC deals (12 deals valued at almost $30 billion), and a surge in PE-backed deals—which grew to 40 percent of volume.

However, momentum stalled in 2022, especially in the second half of the year, with an overall YoY decline in M&A volume of almost 30 percent. This was due to persistently high inflation, labor shortages, and interest rate hikes that pushed up financing costs and reduced ROI–especially impacting financial buyers. In an industry with many fixed-price contracts, companies were often unable to pass on higher costs to end customers and subsequently suffered lower profitability and cash flows.

Supply chains continued to suffer, particularly in commercial aero, where the supply base struggled to rebuild capacity that was scaled back during the pandemic. In a further blow to M&A, the August 2022 Inflation Reduction Act set a new corporate alternative minimum tax, making certain divestitures and acquisitions taxable.

Despite these challenges, valuation multiples remained high, making it increasingly challenging for investment committees and boards to endorse deals.

And finally, SPAC deals dried up in 2022, with SPAC transaction volume down by 50 percent, and just $7 billion in deal value. This was driven by increased SEC scrutiny, disappointing performance of de-SPACed companies with lofty forecasts and high redemption rates.

The commercial airline sector is hoping for a sustained period of high air travel demand.

Unpredictable outlook. Within the current uncertainty, buyers and sellers will be keeping a close eye on inflation and the easing of supply chain and labor constraints. High interest rates, and the severity and length of any economic downturn, are likely to affect market sentiment. Casting a shadow over everything is the Ukraine conflict, and the possibility of escalation and involvement of further actors.

The commercial airline sector is hoping for a sustained period of high air travel demand, wondering whether business and long-haul travel can ever return to prepandemic levels. It's also hoped that the current debt ceiling issue will be resolved favorably, although there are fears of budget cuts similar to those experienced in the Budget Control Act of 2011. The Federal Trade Commission and the Department of Justice could conceivably apply stricter regulations and scrutiny, which could potentially reduce cross-border deal activity and large corporate-wide mergers.

In such an uncertain environment, investment in emerging technologies such as sustainable aviation fuel (SAF), electrification, AI, and advanced defense systems could be reduced. That could result in a shift of investment priorities away from these subsectors in the near term.

Future possible M&A trends. While investors are expected to continue to be drawn towards "hot" M&A areas such as space, intelligence, surveillance and reconnaissance (ISR), cyber, and proprietary systems and technologies, deal composition is likely to shift back towards commercial aerospace. This could fuel continued M&A activity, especially in fragmented, lower-tier segments such as aftermarket/maintenance, repair, and overhaul (MRO), engineered and machined components.

Large corporates may place renewed focus on portfolio reshaping, to streamline capabilities and offload non-core assets acquired at the height of M&A activity both in 2021 and pre-pandemic. Higher up the value chain, larger players might engage in vertical integration plays to bring strategically important but capital-constrained suppliers in-house.

The recent shift in relative dominance of the commercial aero OEM duopoly, and the emergence of new entrants as well as program mix shifts may drive a change in deal composition. This could force buyers to favor companies with outsized exposure to higher growth platforms and to OEMs with larger market share. Some mid-cap public companies may also be taken private in a bid to drive efficiencies.

Despite the tough financing climate, PE firms have amassed significant dry powder and continue to be attracted to middle market, highly strategic, growth-oriented A&D segments. These include space, engineered components, MRO and aftermarket, and Cyber. PE firms may deploy alternative financing solutions like higher equity. Under-performing SPACs may be taken private with limited scope for new SPAC/VC deals.

In the defense sector, the war in Ukraine is increasing demand for conventional weaponry, which could reorient M&A towards lower-tech ammunitions and armaments, missile defense, and ground system providers.

In this complex and volatile environment, buyers are likely to be more selective in their M&A pursuits, seeking businesses that can deliver on forecasts. Given inflationary pressures, pure cost synergies may not be enough to create value for buyers, who may need to achieve revenue synergies to meet their financial goals.

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Data was sourced from Capital IQ, Dacis, and company reports.

Outlook

Pent-up demand expected to drive gradual rise in deal activity

Volatility, inflation, and high interest rates have dominated the macroeconomic landscape and impacted M&A deal volumes. Even within this climate, a pipeline of sellers combined with the significant amount of well-capitalized acquirers should lead to modest increases in deal activity in 2023.

Overall deal volume, including sell-side activity by PE firms and corporate carve-outs, declined significantly in Q4 2022 and early 2023 as higher interest rates and global unrest heightened market uncertainty, causing a pullback from both buyers and sellers. However, M&A should rebound in the latter half of 2023 as PE firms feel pressure to deploy dry powder and monetize investments held well beyond their typical holding periods. Large corporates should look to reshape their portfolios, exiting noncore capabilities inherited as part of the recent M&A wave. Strategic divestiture remains a critical component of industrial manufacturers' M&A plans, as they look to find "better owners" for legacy assets.

In addition to the uninvested capital overhang from the substantial growth in the PE sector, strategic buyers are in strong cash positions. While buy-side pressure will ramp up, we expect acquirers to remain highly selective in the assets they pursue, setting demanding metrics. As sellers begin to come to terms with lower valuations, we believe the second half of 2023 should be active. Continued high cost of capital and lower debt availability, along with increased regulatory scrutiny, may prove a barrier to larger deals. Activity should be concentrated in the lower and middle markets, which tends to be less volatile with capital structures that are more conservative.

Financing has been more challenging for PE players, forcing alternative structures including investing more equity up front, with the intention of refinancing once interest rates eventually come down.

In terms of target opportunities, niche industrial technology companies will continue to be popular, as will increasingly distressed (especially lower-tier) suppliers struggling to meet capacity expansion demands. We expect to see interest from both PE firms and industrials making vertical integration plays to bring key capabilities in-house and take advantage of synergies. As with any market uncertainty, the current environment favors the patient buyer versus the anxious seller.

Key considerations as we look ahead

Amid continued volatility, dealmakers should be aware of the following:

1 Avoid excessive caution

No one wants to overpay, but a good acquisition should be about the longer term. That means you should be willing to step up and pay a reasonable price for an asset that meets your strategic goals—even in a depressed market.

2 Understand true drivers of future performance

Don't just focus on revenue—make sure you stay on top of underlying market dynamics like consumer spending levels.

3 Be realistic about synergies

Given labor constraints for both acquirer and target teams, it is challenging to achieve cost and revenue synergies. Consider how you can get the support you need to size up and execute synergies and track value in order to deliver desired ROI.

4 Divest businesses to fund growth ambitions

When the market returns, be ready to market and sell those businesses with "better owners".

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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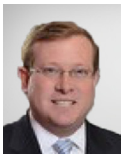

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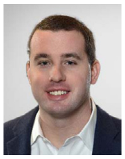

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