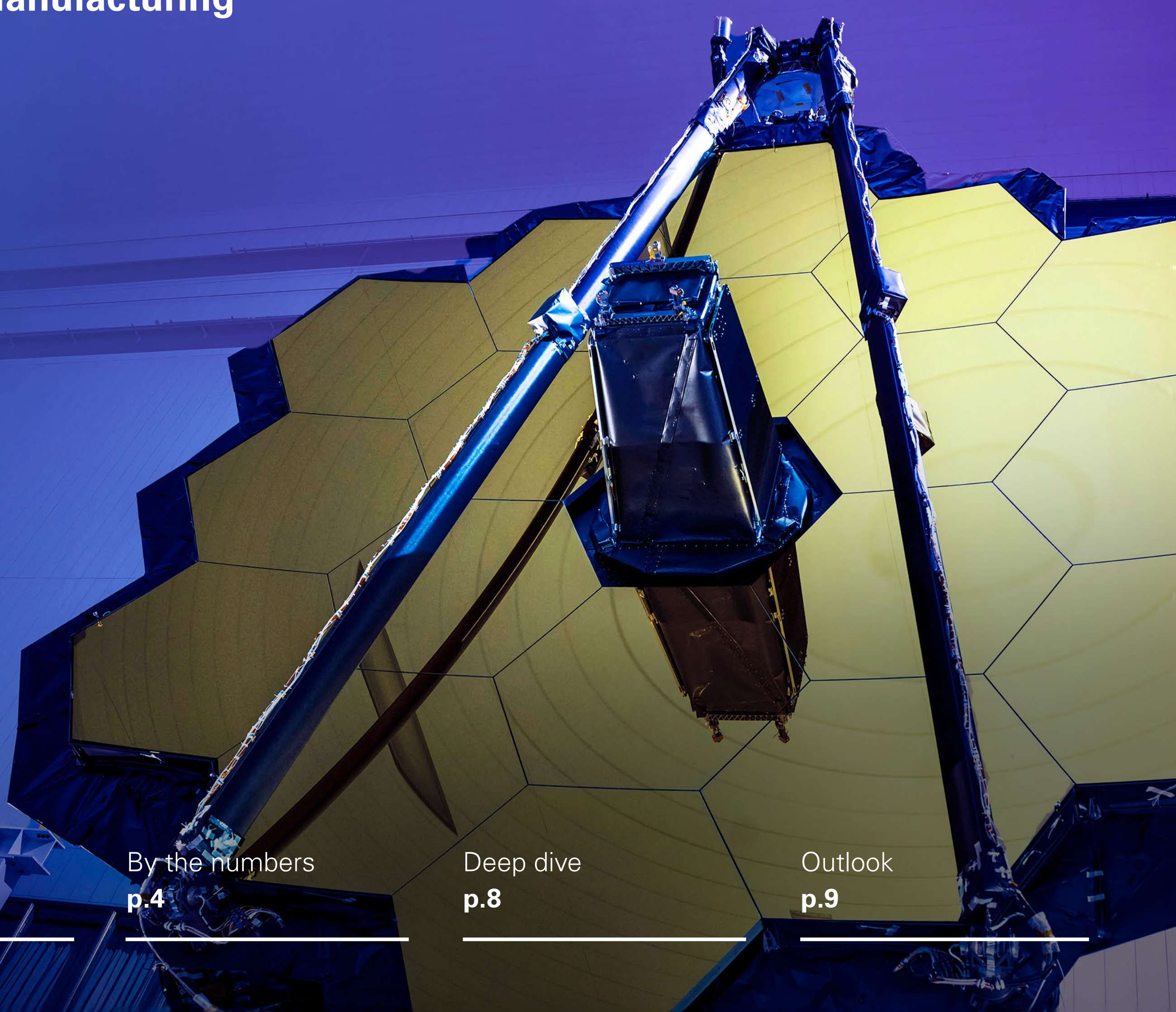
The beat goes on

M&A trends in industrial manufacturing



Q3’23

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Introduction

Stuck in first gear

In an economic climate that has remained challenging for the past several quarters, the industrial manufacturing sector continued to experience less than robust merger and acquisition (M&A) activity in Q3'23 thanks largely to compound volatilities[1] (e.g., recession fears, cost of capital, geopolitical instability, supply chain fragility).

The overall volume and value of IM transactions declined, continuing the slide that began in Q2'23. Private equity (PE) investors mostly stayed on the sidelines, but that isn't the whole story—strategic dealmakers continued, albeit at a slower pace, to establish robust processes for selling highly valued assets and paying robust prices to acquire those high-quality businesses.

As we speak with our clients, the word of the moment seems to be "discipline." Both corporate and PE buyers are emphasizing rigor in the diligence process, testing a wide range of scenarios, and looking to avoid both missed opportunities and overzealous pursuits.

Advanced technology is transforming IM, and as companies seek to redefine themselves as smart industrial manufacturers, quality assets will continue to come to market and generate robust processes. Corporate strategists look to trim assets that do not fit into that strategy and acquire those that accelerate the transformation. For instance, BAE Systems has agreed to pay $5.6 billion to add the advanced tech capabilities of Ball Aerospace & Technologies to its defense and intelligence businesses.

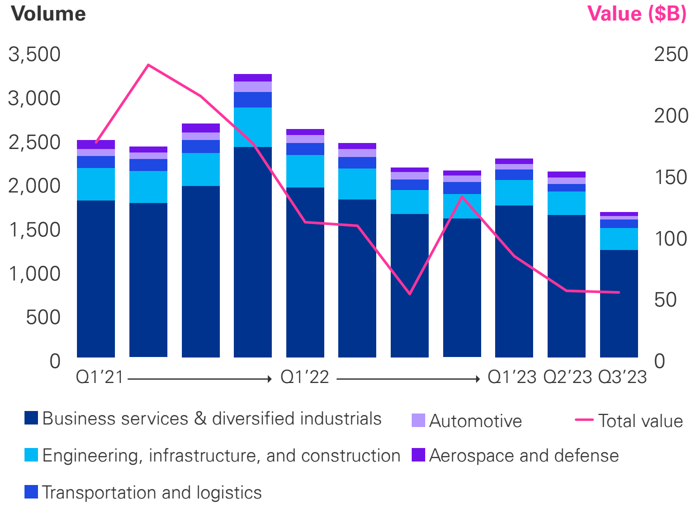
As companies seek to acquire new technologies and capabilities, we expect that these several quarters spent preparing will pay off in heightened activity and a healthier market.

Todd Dubner
Principal
Deal Advisory & Strategy Leader
Industrial Manufacturing

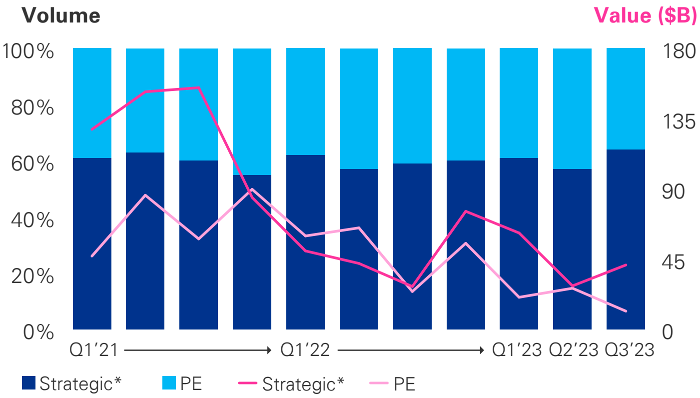
Q3'23 highlights

1,656 deals | ▼ **-22%** decrease QoQ | **$52.8** billion deal value | ▼ **-2%** decrease QoQ

IM deal activity by sector



IM deal activity by type



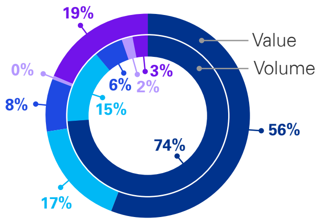
*Includes SPAC deal activity

[1] "Mastering compound volatility: Strategies for business leaders to get through the next quarter—and the next five years," KPMG, 2023

Q3'23 deal mix

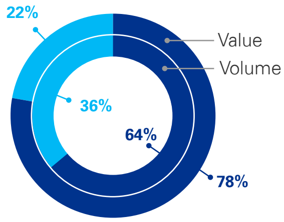
Outer ring represents value, inner ring represents volume.

Sector mix



- Business services & diversified industrials
- Engineering, infrastructure, and construction
- Transportation and logistics
- Automotive
- Aerospace and defense

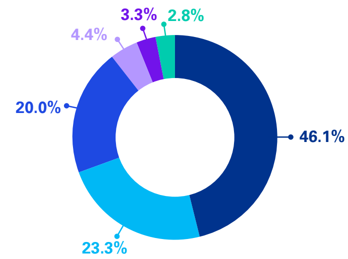
PE/Strategic mix



- Strategic*
- PE

Includes SPAC deal activity

Value size mix



- < $25M
- $25M–$99M
- $100M–$499M
- $500M–$999M
- $1B–$2.49B
- > $2.5B

Top strategic deals

Acquirer	Target	Value (billions)
Smurfit Kappa Group Plc	WestRock Company	$11.2
BAE Systems, Inc.	Ball Aerospace & Technologies Corp.	$5.6
Thales S.A.	Imperva, Inc.	$3.6
Forward Air Corporation	Omni Logistics, LLC	$3.2
Summit Materials, Inc.	Argos USA Corporation	$3.2

Top PE deals

Acquirer	Target
Clayton, Dubilier & Rice	Veritiv
GTCR	ADT Security Services
J.F. Lehman & Company	Heritage-Crystal Clean
Abu Dhabi Investment Authority	Daiwa House Industry
Global Principal Partners, Koch Minerals & Trading, TPG	Hybar

About the data: Data was sourced from CapitalIQ, Refinitiv, Pitchbook, and KPMG analysis. The Q3'23 values and volumes data cited are for U.S. deals announced between 7/1/2023 and 9/30/2023. 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 outcomes.

By the numbers

Aerospace and defense

Consolidation continues

Aerospace and defense companies are increasingly pivoting to an introspective view of their portfolios, recognizing that years of focus on growth have resulted in opportunities to shape portfolios and focus on their core. The number of A&D transactions declined from 64 in Q2'23 to 49 in Q3'23, while the total value of disclosed deals saw a significant increase from $3.9 billion to $9.8 billion driven by two large transactions: BAE Systems' acquisition of Ball Aerospace & Technologies Corp. for $5.6 billion and Thales Group's acquisition of Imperva Inc. for $3.6 billion.

BAE, the British defense giant, reasoned that CO-based spacecraft company Ball Aerospace & Technologies adds another fast-growing technology business to its portfolio. Thales, a leading defense electronics company based in Paris, reasoned the CA-based Imperva will enhance its cybersecurity capabilities and create a globally integrated cybersecurity provider. Thales said the price of the acquisition from buyout firm Thomas Bravo implied an enterprise value of 17 times 2024 operating earnings forecasts.

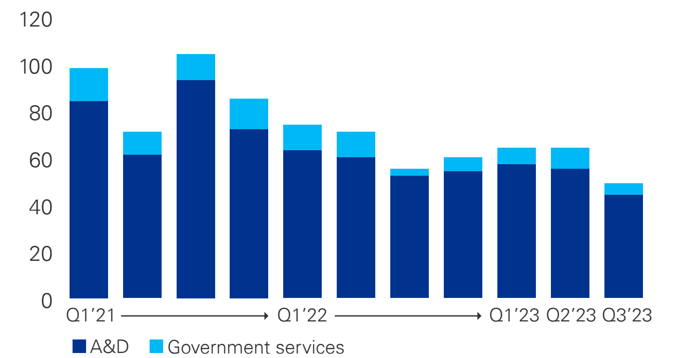
Strategic deal activity has remained relatively steady going back to Q4-22, as companies continue to evaluate current businesses and align focus on core activity. PE deal activity has focused primarily on strategic add-on acquisitions throughout 2023, as firms continue to evaluate current portfolio companies and look for growth opportunities.

Q3'23 highlights

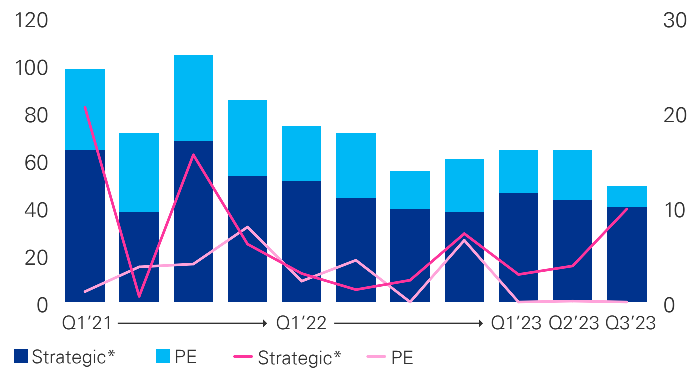
49 deals ▼ **-23%** decrease QoQ

$9.8 billion deal value ▲ **149%** increase QoQ

A&D deal activity by subsector



A&D deal activity by type



*Includes SPAC deal activity

Top A&D deals

Acquirer	Target	Rationale
BAE Systems, Inc.	Ball Aerospace & Technologies Corp.	Add a high-quality, fast-growing tech-focused business
Thales S.A.	Imperva, Inc.	Enhance cybersecurity capabilities
Volato, Inc.	PROOF Acquisition Corp	Go public via SPAC merger
Parsons Corporation	Sealing Technologies, Inc.	Increase share in cyber operations market
Set Jet Inc.	Revelstone Capital Acquisition Corp.	Go public via SPAC merger

"Given the dry powder still in the market, we anticipate increased M&A in 2024, though not the exuberance of the 2021-2022 timeframe." —Andrew Kersse, Partner, Advisory

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[2] Tim Hepher, Mathieu Rosemain, "France's Thales to buy Imperva in $3.6 billion cybersecurity deal," July 25, 2023, Reuters

By the numbers

Automotive

Short-term parking

Uncertainties due to the cost of capital, labor unrest, and China-U.S. decoupling are driving the downward trend in dealmaking, and Q3'23 proved disappointing to automotive sector investors. Strategic and PE deals both declined, with 15 strategic and 23 PE transactions announced or completed, compared with 34 and 38 deals, respectively, in Q2'23. The share of strategic versus PE deals remained relatively stable, with the former gaining almost 12 percent at the expense of the latter.

The value overall of deals done in the sector declined dramatically, as evidenced by the largest deal, at a relatively low $130 million: the purchase by ABC Technologies Holdings of the automotive business of Plastikon Industries, which supplies auto interiors and electric vehicle (EV) battery housings. The acquisition is aimed at increasing ABC Technologies' capabilities in the EV market and gives the company a first-mover advantage in the future of mobility.

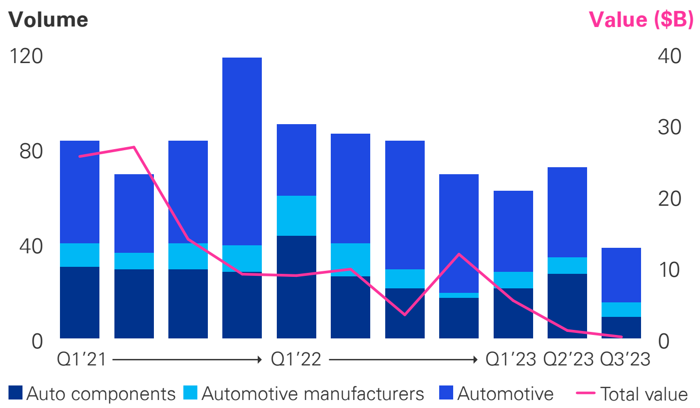
Tier 1 suppliers continue to rationalize their portfolios and ready assets for possible divestiture, but inflationary pressures and production volume volatility have caused sellers to underperform their projections, resulting in deals taking longer to close or being halted altogether. Good quality companies can still command an attractive valuation, but in this uncertain environment, many high-quality deals remain on the sidelines waiting for market conditions to improve.

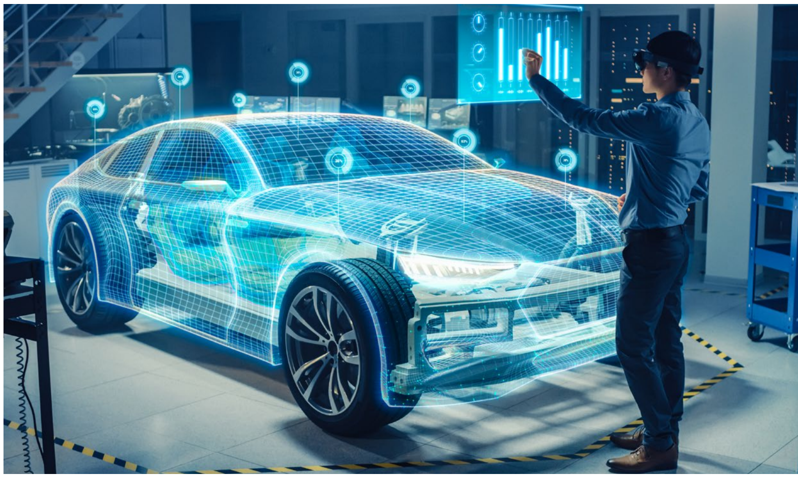
Q3'23 highlights

38 deals ▼ **-47%** decrease QoQ

$0.2 billion deal value ▼ **-81%** decrease QoQ

Automotive deal activity by type





Top automotive deals

Acquirer	Target	Rationale	Value (billions)
ABC Technologies Holdings Inc	Automotive business of Plastikon Industries	Increase EV capabilities	$0.1

"Financial sponsor dry powder remains high and corporate buyers continue to reach out looking for deal flow."
—Ford R. Phillips, Managing Director, Advisory

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By the numbers

Engineering, infrastructure, and construction

Building M&A takes a tumble

Overall Q3’23 activity was down from Q2—the sole increase in deal volume was recorded by the homebuilding subsector, which announced 12 transactions in Q3 versus six in Q2. Deal value, however, increased across the board, driven by one megadeal in construction materials.

That large transaction was the acquisition by Summit Materials of Argos USA Corp. for $3.2 billion, under the rationale of supporting Summit’s materials-led portfolio strategy. This transaction propelled the construction materials subsector to a huge increase in the total value of deals done versus during the previous quarter.

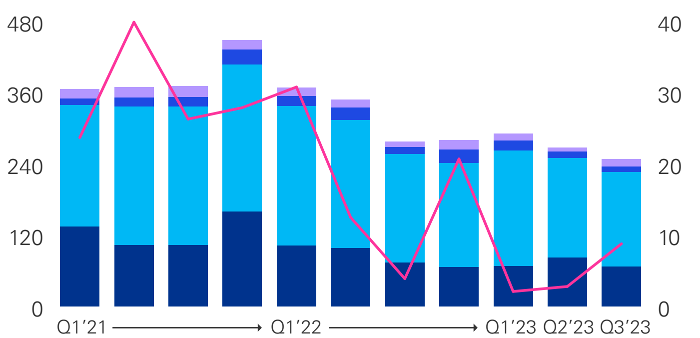
Beacon Roofing Supply closed its acquisition of Crossroads Roofing Supply for $810 million, further advancing its strategy of branch expansion through acquisition.

Largely as a result of these deals, strategic transactions in the sector increased their share of transactions by 57.4 percent versus the previous quarter, at the expense of PE investors.

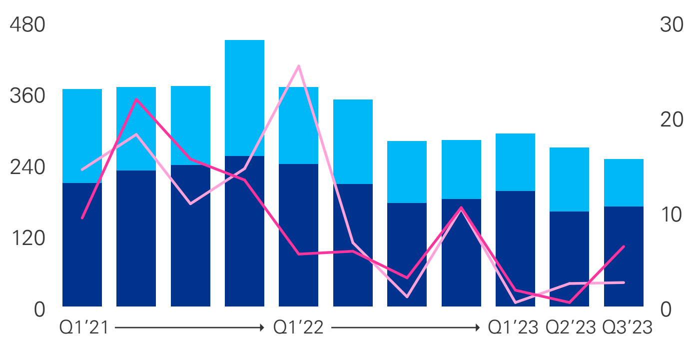
Q3’23 highlights

248 deals ▼ **-7%** decrease QoQ | **$8.8** billion deal value ▲ **217%** increase QoQ

EIC deal activity by subsector



EIC deal activity by type



*Includes SPAC deal activity

Top EIC deals

Acquirer	Target	Rationale	Value (billions)
Summit Materials, Inc.	Argos USA Corporation	To support their material-led portfolio strategy	$3.2
Abu Dhabi Investment Authority	Daiwa House Industry	Enhance portfolio in Japan and compete in pan-Asia market	$0.9
Beacon Roofing Supply, Inc.	Crossroads Roofing Supply, Inc.	Expand midwest footprint and operational expertise	$0.8
Qatar Investment Authority	Park Lane Hotel	Expand geographically and improve asset management	$0.6
Champion Home Builders, Inc.; Champion Retail Housing, Inc.	Regional Enterprises LLC	To expand geographically and improve production capacity	$0.5

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By the numbers

Transportation, logistics, and distribution

Moving right along

In Q3'23, the number of transportation, logistics and distribution (T&L) deals increased by 6.6 percent compared with Q2'23, while the total value leaped 348 percent thanks largely to one large transaction: Forward Air's announced $3.2 billion purchase of Omni Logistics.

Forward Air Corp. is a leader in expedited less-than-truckload (LTL) shipping. Its proposed acquisition of Omni Logistics, which is PE-owned, enhances its strategy in a business driven by the expansion of online commerce. The deal surprised some observers due to the resulting 37.7 percent equity stake for Omni's shareholders and the assumption of $1.4 billion in net debt. In addition, Forward's existing customers view Omni as a competitor. A temporary restraining order to block the deal has been issued—it was filed by three shareholders who are former employees; they claim Forward's shareholders were entitled to vote on the transaction under Tennessee law.

The second-largest deal in Q3 was Wanshun Technology Industrial Group's purchase of AlphaVest Acquisition Corp. for $300 million, a SPAC transaction designed to take the merged business public.

The activity in T&L in Q3 was all about the air, water, road, and rail subsector, which announced 90 deals (compared to seven in the transportation infrastructure subsector) worth $4.1 billion in deal value.

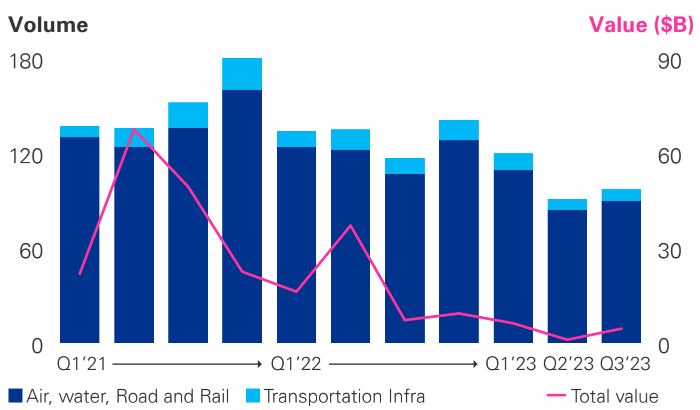
Compared to Q2'23, PE deals were down slightly in volume and 40 percent in value.

Q3'23 highlights

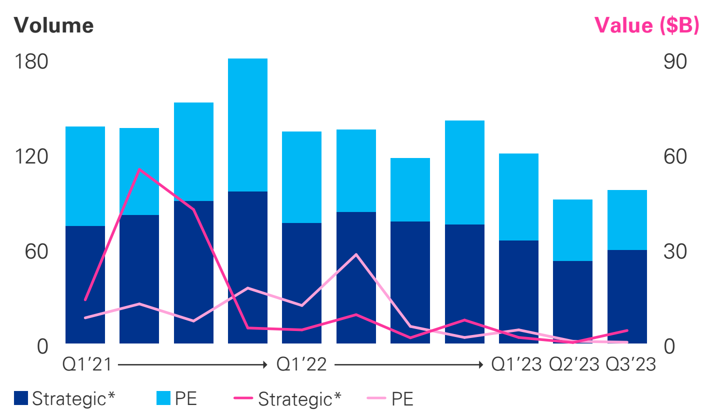
97 deals ▼ **-7%** decrease QoQ

$4.5 billion deal value ▲ **348%** increase QoQ

TLD deal activity by subsector



TLD deal activity by type



*Includes SPAC deal activity

Top TLD deals

Acquirer	Target	Rationale	Value (billions)
Forward Air Corporation	Omni Logistics, LLC	Expand portfolio to offer multimodal solutions	$3.2
Wanshun Technology Industrial Group Limited	AlphaVest Acquisition Corp	Go public via SPAC merger	$0.3
MiddleGround Capital	Xtrac	Platform acquisition to develop the PE firm's portfolio	$0.3
Schneider National, Inc.	M&M Transport Services, Inc.	Expand reach and portfolio	$0.2
GXO Logistics, Inc.	PFSweb, Inc.	Expand North American presence in e-commerce luxury brand order fulfillment	$0.2

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Deep dive

BuildingTech promises to be a good investment for discerning investors

Construction and real estate, a space buzzing with startup and venture capital activity, is getting ready for prime time for PE and larger M&A transactions. The allure of BuildingTech is growing, for both corporate and PE investors. However, investors need to understand potential setbacks: most of these companies struggle to scale, and some common investment guidelines are "inverted" in this space.

Through our 2023 Global Construction Survey[3] and insights from our M&A advisory teams in a recently published paper, "Nailing the deal,"[4] we have developed a primer on the sector's complexities that can help clarify the investment picture.

The terms PropTech, ConTech, CRETech (and AECTech and Smart-building-Tech, etc.) comprise a nebulous cloud of hundreds of overlapping technology solutions intended to improve productivity in building design, construction, and operation and help owners manage and finance projects, manage portfolios, and service buildings. We have developed an eight-part framework to help categorize technologies into peer sets.

Category	Technology that involves...	Primary users/buyers of this technology
Design	Building plans and cost estimates, including through permitting and specifications	Architects, engineers, developers
Construct	Site-based activity, including off-site construction technology and safety solutions	Construction companies, materials manufacturers
Project manage	Tracking and documentation of construction activity including completion, costs, and compliance	Construction companies
Finance	Obtaining funding for building construction	Developers, investors, owners
Search, buy, sell	Matching buyers and sellers of real estate, including through better data	Investors, owners
Manage portfolio	Overseeing a set of properties, including rent management	Owners
Utilize the asset	Increasing use of and foot traffic into the property	Owners, tenants
Service and repair	Tracking building operations and performing or monitoring repair activity	Owners, building materials manufacturers

Scaling has been challenging for most BuildingTech companies, as the real estate and construction sector is highly localized, the players risk-averse, and development timeframes lengthy. While there are several attempts to create an end-to-end workflow solution that spans multiple categories and use cases, we estimate that over 50 percent of BuildingTech offerings are point solutions that narrowly target one step or need in a job site or building management lifecycle. One of our clients clearly described pushback from the field: "For every new technology or app that folks want to roll out, it needs to replace five or six existing steps or solutions, otherwise it will not be accepted." We expect continued market pressure to develop solutions that begin to consolidate that workflow.

Because the industry is fairly new, we saw venture capital involvement rising from 40 percent to over 60 percent of all deals in 2022. Over time, we note an upswing in PE activity and expect more as businesses mature—and correspondingly larger checks.

Corporate M&A has also been increasing, despite the recent, more subdued deal market. This suggests a shift from viewing innovative technologies as a threat to accepting them as a competitive advantage in a labor-constrained sector.

Our experience supporting companies through BuildingTech transactions has helped us identify some common misconceptions when assessing potential investments. For instance, rather than unlock SaaS-like valuation, BuildingTech is often characterized by high acquisition costs and churn rates. And while the total addressable market for BuildingTech is huge, construction nuances make delivering on "one size fits all" claims challenging. More product features are not necessarily better—construction companies want to replace, not add to, their technology stack.

Further, customer diversification may reflect testing out of a product in the early stages of company growth, but revenue projections associated with a focused effort on a few customers/partners should show profitability improvement over time. While most companies' funding is multiply sourced, strategic customer partnerships are critical long term, because the learning curve is most effectively approached, and financed, over a set of similar projects.

Any investor considering a transaction in the BuildingTech space must understand these complexities. Beyond due diligence on the product technology assessment and how the product will support the building across its lifecycle, the investment case needs to clearly outline who will buy the technology and who will use it.

Serena Crivellaro
Managing Director
Deal Advisory & Strategy

[3] "2023 Global Construction Survey: Familiar challenges—new approaches," KPMG, May 2023

[4] "Nailing the deal: How to successfully execute building construction, real estate, and technology M&A," KPMG, 2023

Outlook

Clearer skies ahead—perhaps

Merger and acquisition activity in the IM sector may need a few more quarters to shake off the doldrums. Political uncertainties abound, not just because of the continuing war between Russia and Ukraine and the new Mideast war, but domestically as U.S. national elections approach. Inflation is declining, and economists do not expect that the Federal Reserve will hike interest rates again in 2023.

In the IM sector, durable goods orders fell sharply during Q3'23, industrial production hovered around zero, and more banks tightened lending standards on commercial and industrial loans than in Q2'23. However, excluding motor vehicles and parts, output in Q3 was up 1.7 percent on an annualized basis and PMIs are strengthening, which provides some hope that by mid-2024, if inflation keeps declining, interest rates flatten, and credit eases up, the economy will begin to run on all cylinders.

When that happens, dealmakers will be quick to pounce on the high-quality assets they have been eyeing. An improved macroeconomic picture should encourage increased consolidation and vertical integration as IM companies look to transform their organizations into smart industrial manufacturers. Technology will propel dealmaking across the board: in the buildings and construction sector, we expect investment activity around BuildingTech to heat up. In automotive, Tier 1 suppliers recognize they need to get up to speed for an EV world, and that means gearing up to produce everything from EV battery housings to charging equipment. We expect the combination of pent-up demand for deals and significant financial-sponsor dry powder to add up to a deal rebound in early 2024. For aerospace and defense companies, we expect investments in the high-tech sector to pick up as decoupling from Asia gains momentum, and second- and third-tier players will be able to continue consolidation moves when economic headwinds dwindle.

We expect that given the recent quarters spent looking introspectively at portfolios and the amount of pent-up strategic initiatives—as well as cash reserves—there will be increased M&A activity in 2024, though perhaps not with the exuberance of past years. For now, both corporate and PE buyers are emphasizing rigor in the diligence process, testing of a wide range of scenarios, and discipline in the process.

Key considerations as we look ahead

In pursuing M&A in an economic downturn, IM dealmakers should think about the following:

1 Be disciplined

Sellers will play hardball, so extra due diligence and an understanding of how an acquisition will enhance future earnings are key.

2 Stick to the strategy

If assets no longer fit the strategy, find the best buyer and divestment plan and be ready to move when the market is right.

3 Focus on tech

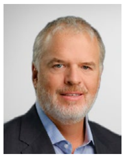
Tech-related transactions that advance a smart IM strategy should be high on your list.

How KPMG can help

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.

Authors



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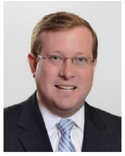

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