



Opus Connect

Manufacturing/ Industrial Sector Report

2020

How the Manufacturing/Industrial
Deal Pipeline is Faring After COVID-19





TABLE OF CONTENTS

01 | Introduction

01 | Methodology

01 | Demographic

02 | Research & Questions

02 | Deals

03 | Challenges

05 | Portfolio

06 | Platforms & Add-Ons

07 | State of New Deals

10 | Market Status

12 | Results Analysis

13 | Index of Contributors

INTRODUCTION

M&A professionals in the manufacturing/industrial sector make up a significant portion of Opus Connect's extensive middle market M&A network, providing valuable insights into the current state of the industry during the challenges of 2020 and the COVID-19 pandemic.

Our findings in this report seek to illuminate the challenges faced by the manufacturing/industrial sector in obtaining deals, conducting due diligence, and adapting to a changed landscape after a pause during the global economic slowdown. The inherent variety within the manufacturing/industrial sector led to a diversity of responses within participants' responses regarding their deal pipelines, access to capital, debt, portfolio management, and more.

Opus Connect's goal is to be a resource to the M&A deal community, conducting this research with the goal of providing a window into the current state of the middle-market manufacturing/industrial sector. A tool for future success, the information gathered aims to promote awareness of current practices as well as the speed and growth potential for deals going forward. Business development strategies are continually changing and growing alongside an industry that is now seeing greater utilization of digital resources and new technologies as some – but not all – parts of the deal process transition to virtual interactions and events. As the global scenario changes, business processes adapt alongside it.

Thank you to our esteemed survey respondents in the manufacturing/industrial sector for sharing their timely experiences and discussing the impact of COVID-19 with us as we all cope with the curveballs of 2020 and the unexpected issues that arise from shifting the ways in which we do business during a global pandemic.

METHODOLOGY

This survey, conducted via one-on-one interviews by Opus Connect CEO, **Lou Sokolovskiy**, in October 2020, reports the views of 29 manufacturing/industrial sector professionals. These views encompass industry outlook, the state of ongoing deals and deals closed during the COVID-19 pandemic, challenges faced in performing due diligence, the quality and quantity of new deals, the state of the debt market, and more.

DEMOGRAPHIC

Our survey respondents are at firms that have been in existence for anywhere from two to twenty years, showcasing a wide range of experience in the industry. All major U.S. regions are represented by our respondent population.

RESEARCH QUESTIONS & RESPONSES

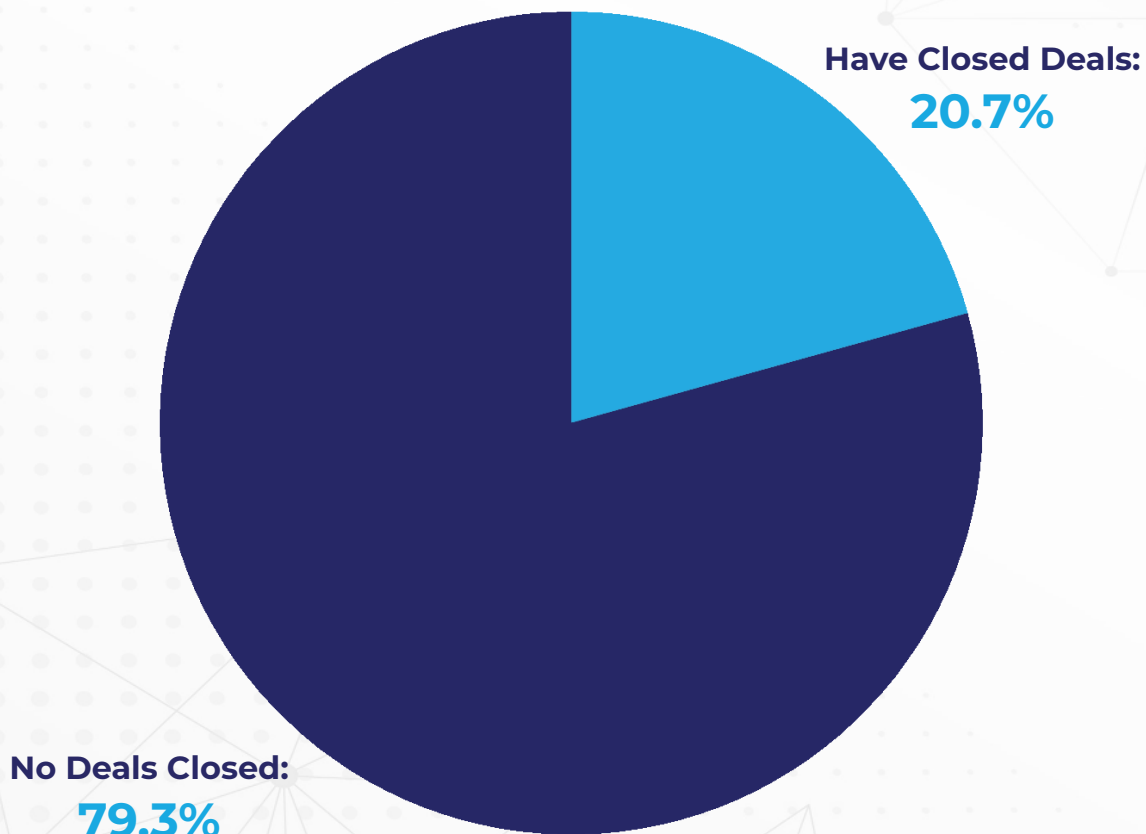
The goal of this section is to provide a snapshot of whether manufacturing/industrial sector professionals have been able to close deals during COVID-19, and whether those deals were already in the pipeline prior to pandemic or were initiated after it began.

A. DEALS

Question 1.1: Have you closed any new manufacturing/industrial deals since COVID-19?

The responses to this reflected the uncertainty of the 2020 market but demonstrate that a few deals are still occurring. Out of the 29 respondents, 23 stated that they had not closed any deals since COVID-19, with six stating that they had closed deals after the pandemic. Deal activity was almost nonexistent Q1/Q2 of 2020, with an uptick in Q3 and revamp into Q4, as many deals are set to close at the end of 4Q2020 and 1Q2021.

Have You Closed Any Deals Post Pandemic?

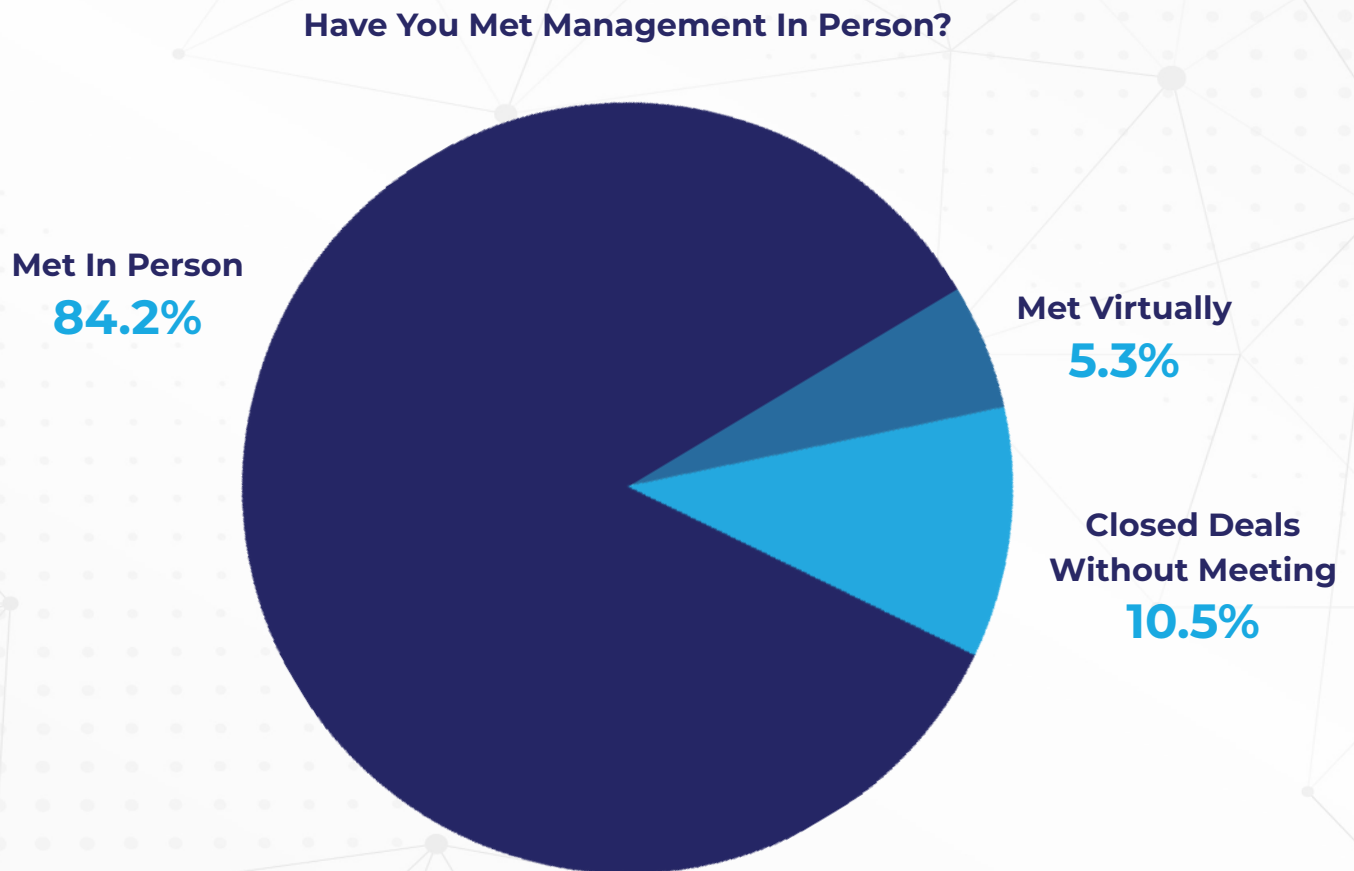


Question 1.2: If yes, have you started and closed any deals during the pandemic?

As only six respondents noted that they had started new manufacturing/industrial deals, four of those deals did begin and close during 2020; one deal had already begun before the pandemic hit and one just closed recently, after the majority of lockdowns and travel restrictions had lifted.

Question 1.3: Have you met the management team in person?

Respondents were split on this issue – 16 had met the management teams in person prior to closing. One manufacturing/industrial professional had met the management team virtually, and two replied that they had closed deals without a face-to-face meeting with the management team.



B. CHALLENGES

Question 2: What kinds of challenges did you face with Due Diligence?

On the issue of due diligence, responses varied through the manufacturing/industrial sector, with a few overlapping thoughts from respondents. Five respondents did not

find due diligence to be more challenging than usual, but they were in the minority. One point in particular that was raised several times by different respondents was that due diligence is more challenging in a virtual environment and does not provide the kind of “quality time” with management that is usually desired when creating deals. Christian Lund noted that “we didn’t get to spend as much time with the management as we usually would, so we set up Zoom meetings as a supplement.”

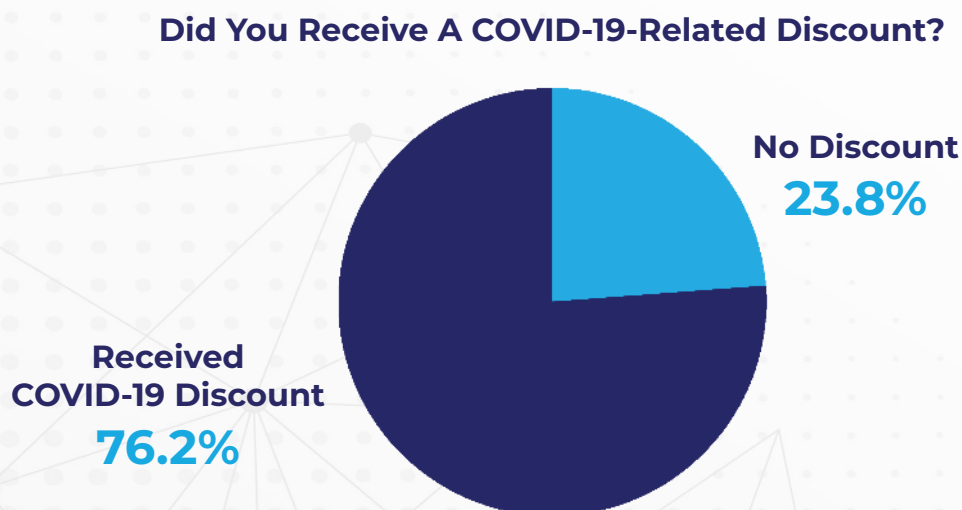
Other challenges that were mentioned include the need to conduct due diligence in an even more meticulous fashion, the extensive measures taken to promote workplace safety, technology challenges associated with “going more digital,” and forecasting struggles. Greg Klein offered his insight, stating that difficulty lies in “predicting when the impact of COVID-19 would end, and how much the lost growth would be until it ends,” demonstrating that many are in the same uncertain boat since the future remains unclear.

Question 3: What kinds of challenges did you face obtaining debt financing?

Eight respondents asserted that they were not having issues when obtaining debt financing, with others offering similarly positive statements. While debt financing was not free of challenges, Bud Moore said that the challenges faced were “more market-related; the debt advanced rate has changed in February; there is a 20%-25% reduction on what we’re seeing on the senior debt side.” Samantha Ory notes that “we had to reevaluate the debt completely. We had to reassess the deal, find new debt and equity for the deal” during the pandemic. Distressed deals were also mentioned as an option and represent a specific kind of deal that is coming to the market slowly.

Question 4: Did you get any COVID-19-related discounts?

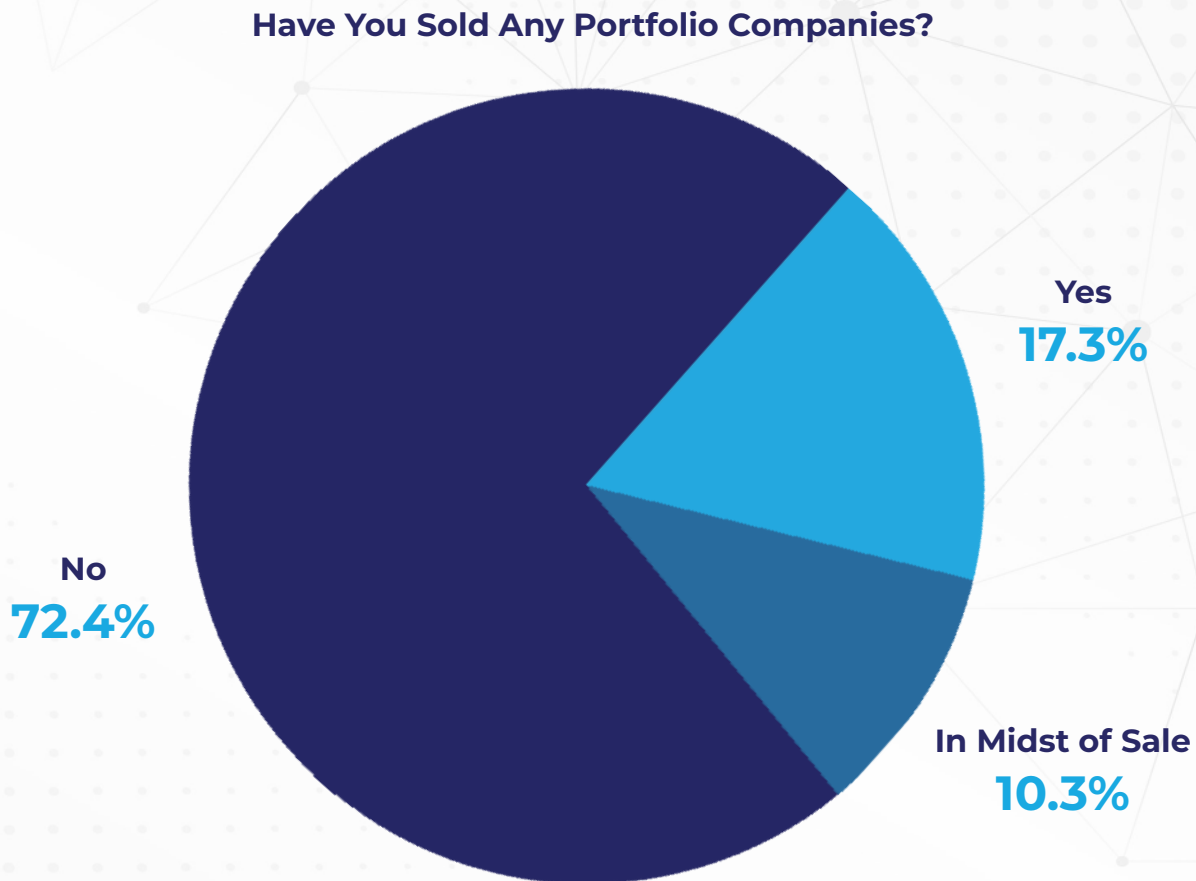
76.2% of respondents received no discount due to the circumstances created by the pandemic, 23.8% of respondents did mention that they received a discount. The insight to be gained from this information is that while there is uncertainty and volatility in global markets, it was not at such a level that the majority of those in the manufacturing/industrial sectors were able to obtain discounts.



C. PORTFOLIO

Question 5.1: Have you sold any portfolio companies?

Regarding portfolio company sales, the majority – 21 respondents – did not sell any of their portfolio companies. Five respondents did, and three are currently in the midst of a sale now that deal activity is picking back up after the third quarter of 2020.



Question 5.2: If yes, what was your motivation?

The five manufacturing/industrial professionals that have sold portfolio companies provided some details into motivation – first, Bud Moore noted that “we have set it up as a five-year investment; the transaction was kind of loaded and ready to go; we also did our return objectives.” Additionally, Dan Lubeck noted that his company had hit on some fortuitous timing to make such a deal: “it is a strategic buyer that has been a supplier of the company for a long time; it is a phenomenal strategic fit.” Similarly, Jonathan Saltzman also was able to reap the benefits of strategic timing: “We were already in the discussion to sell before COVID-19 happened; it was the right time for all the business reasons.” Steven Morgenthal told Opus Connect that his portfolio company deal “was well along in process before COVID-19 hit, and the business was not impacted (by COVID-19).”

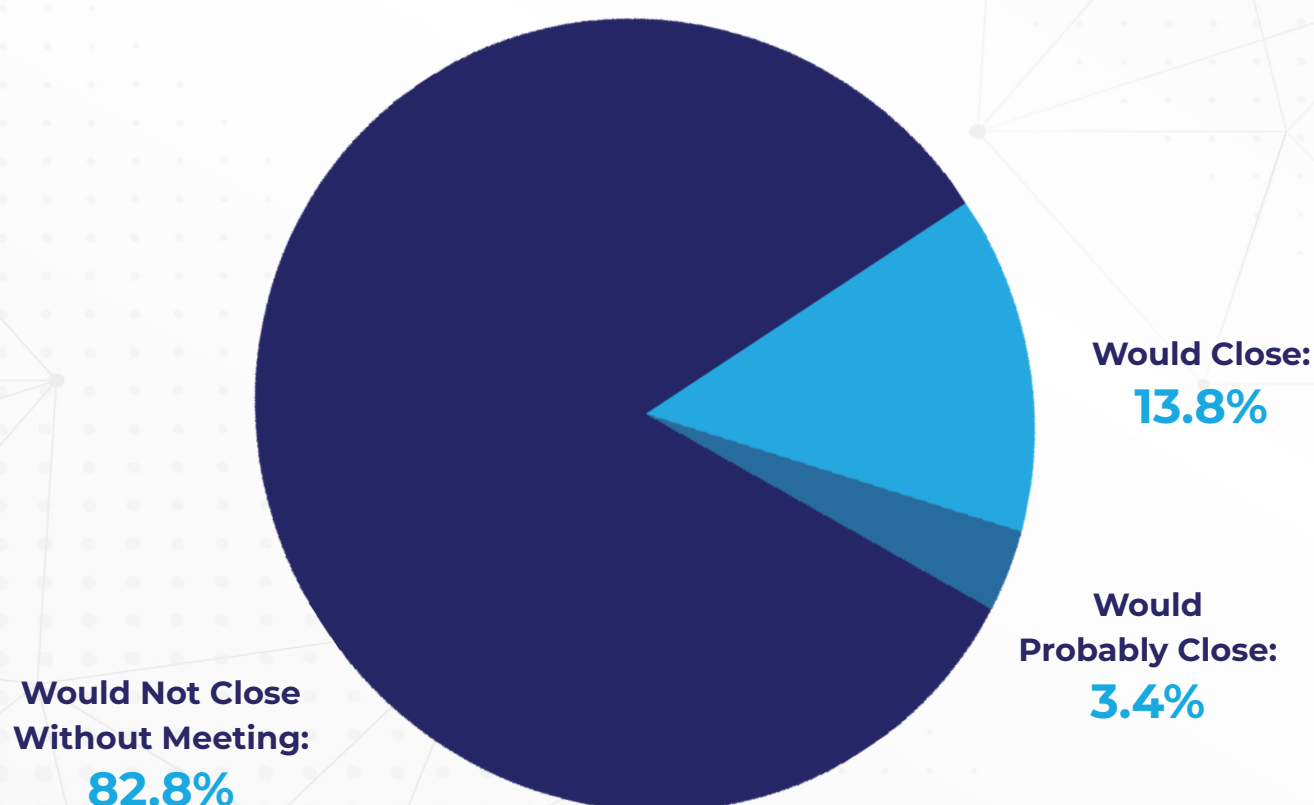
Some manufacturing/industrial businesses have, of course, been positively affected by global need during COVID-19, and deals happening in these necessary sectors are still taking place.

D. PLATFORMS & ADD-ONS

Question 6: Would you close a new platform deal without meeting the management team?

The responses to this query were very straight forward, with 24 respondents stating definitively that they would not close a new platform deal without meeting the management team. Four respondents said that they would, with one hedging their bets and responding “probably”. There is truly no substitute for in-person discussion and gaining insight into a business via face-to-face interactions, although with the advent of Zoom and other forms of virtual telecommunication, a few in the manufacturing/industrial sector are open to closing a new deal without an in-person meeting.

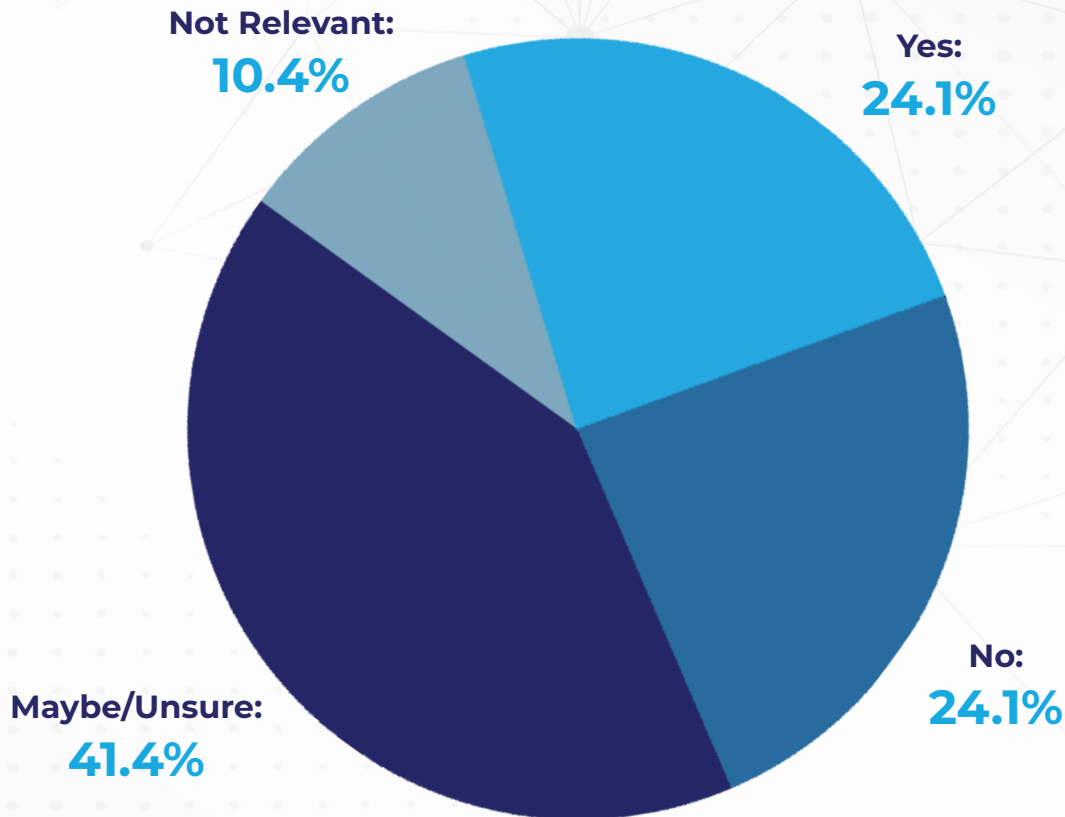
Would You Close A New Platform Deal Without Meeting Management?



Question 7: Would you close an add-on without meeting the management team?

This question garnered a more mixed reaction, with many remaining unsure about their ability to close an add-on without meeting management in person. While three respondents noted that add-ons were not relevant to their company, seven said yes and seven said no, with the majority of 12 respondents replying “maybe/unsure” about this type of transaction.

Would You Close An Add-On Without Meeting Management?

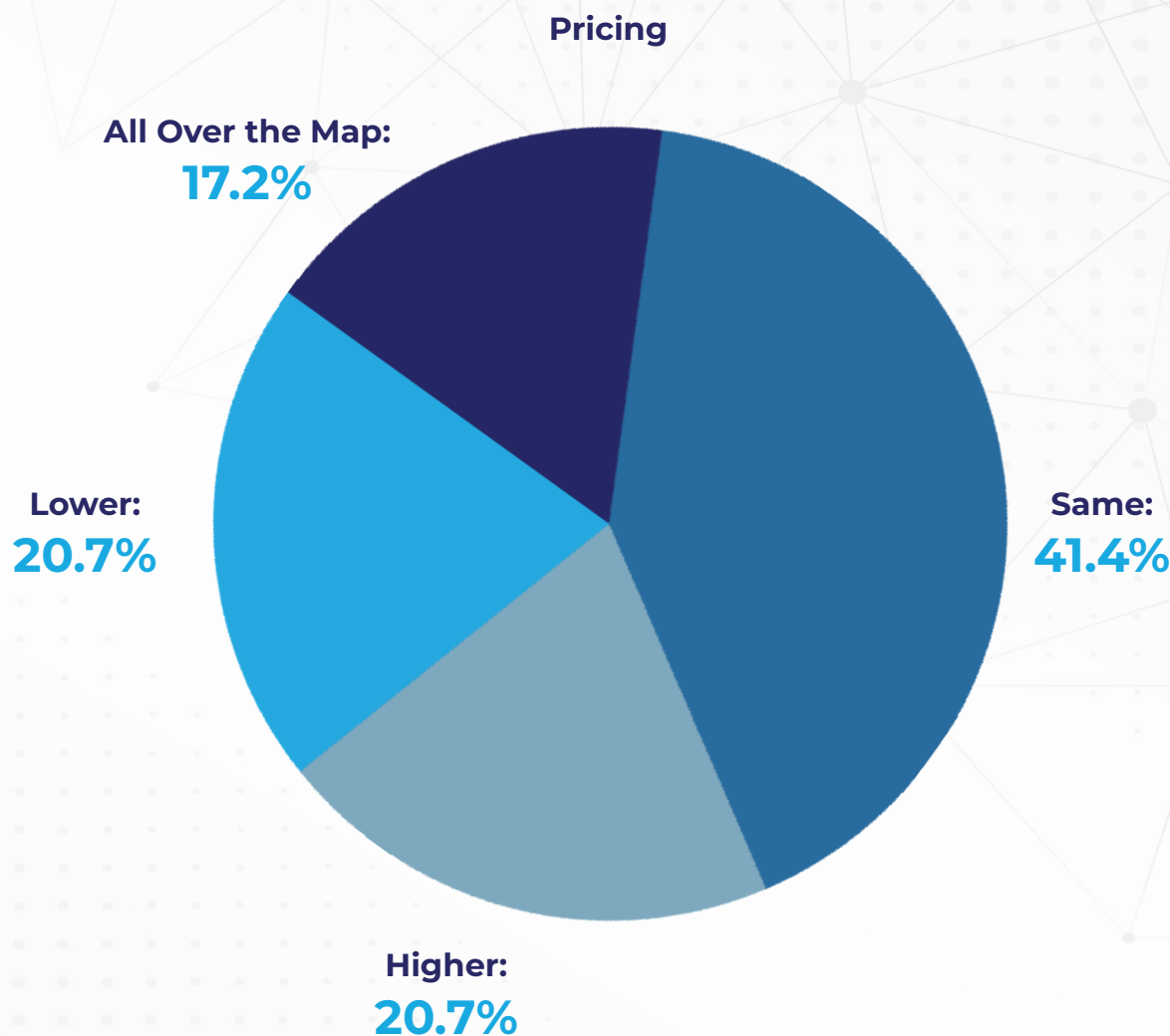


E. STATE OF NEW DEALS

Question 8.1: How do you see the state of your new deals in terms of pricing?

This is a very industry-specific question, and responses will inherently vary by the industry in which the respondent does business within the manufacturing/industrial sector. Pricing, quantity, and quality (as addressed below) of deals during 2020 seemed to vary throughout the manufacturing/industrial sector, with respondents to this query split. Twelve respondents out of 29 said that pricing has not seen much change, with Adam Zacuto noting that “pricing hasn’t changed much and is still very competitive.”

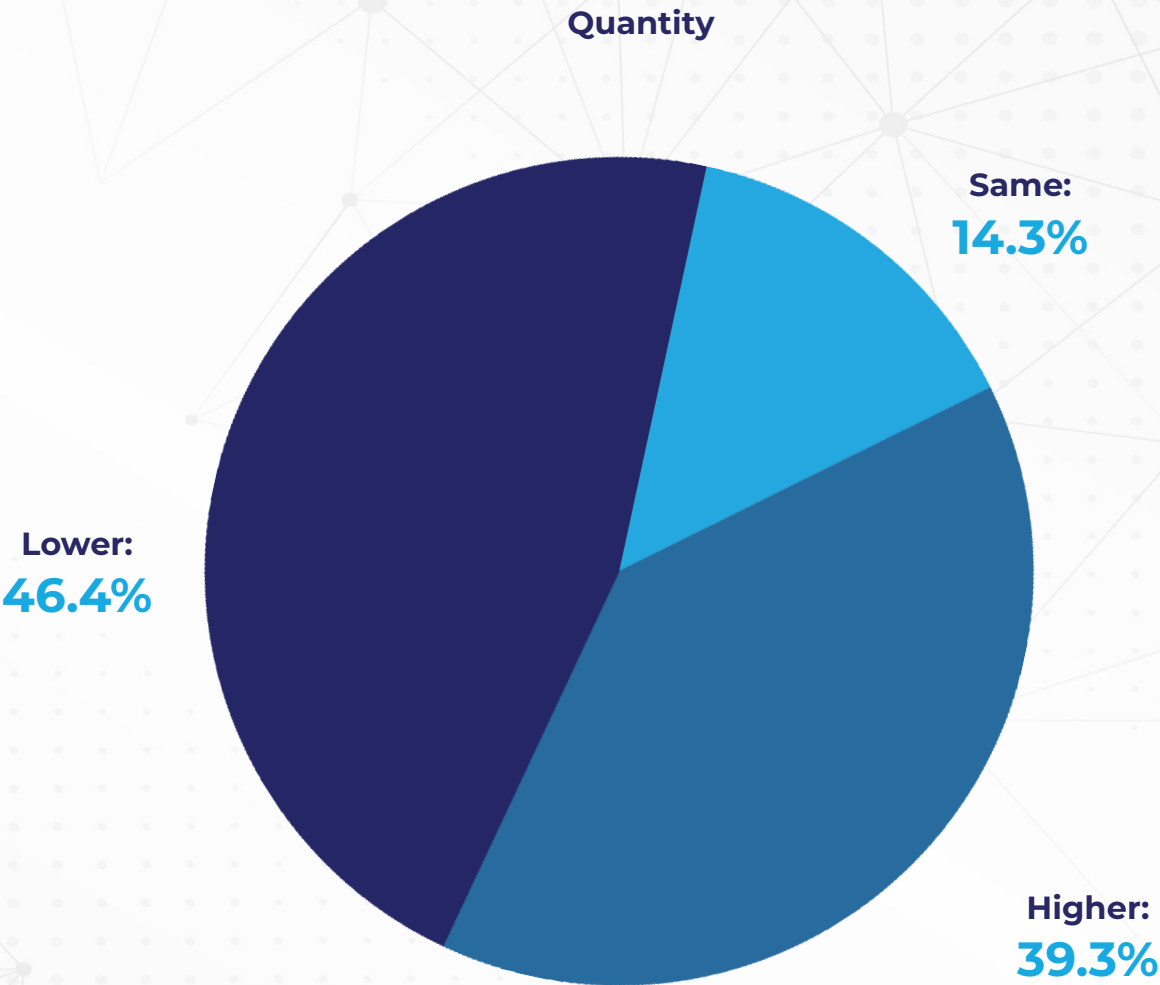
Six out of 29 respondents rate pricing as higher in 2020, having increased after the pandemic. Six respondents rate pricing as lower, with three in that category stating that it was “in the buyer’s favor,” while five of these manufacturing/industrial sector professionals noting that it is “all over the map,” as Bud Moore asserts. Nicholas Janneck’s statement supports this as well, as he notes that “there is a divide in pricing; well-performing deals are trading, and the opposite are not.”



Question 8.2: How do you see the state of your new deals in terms of quantity?

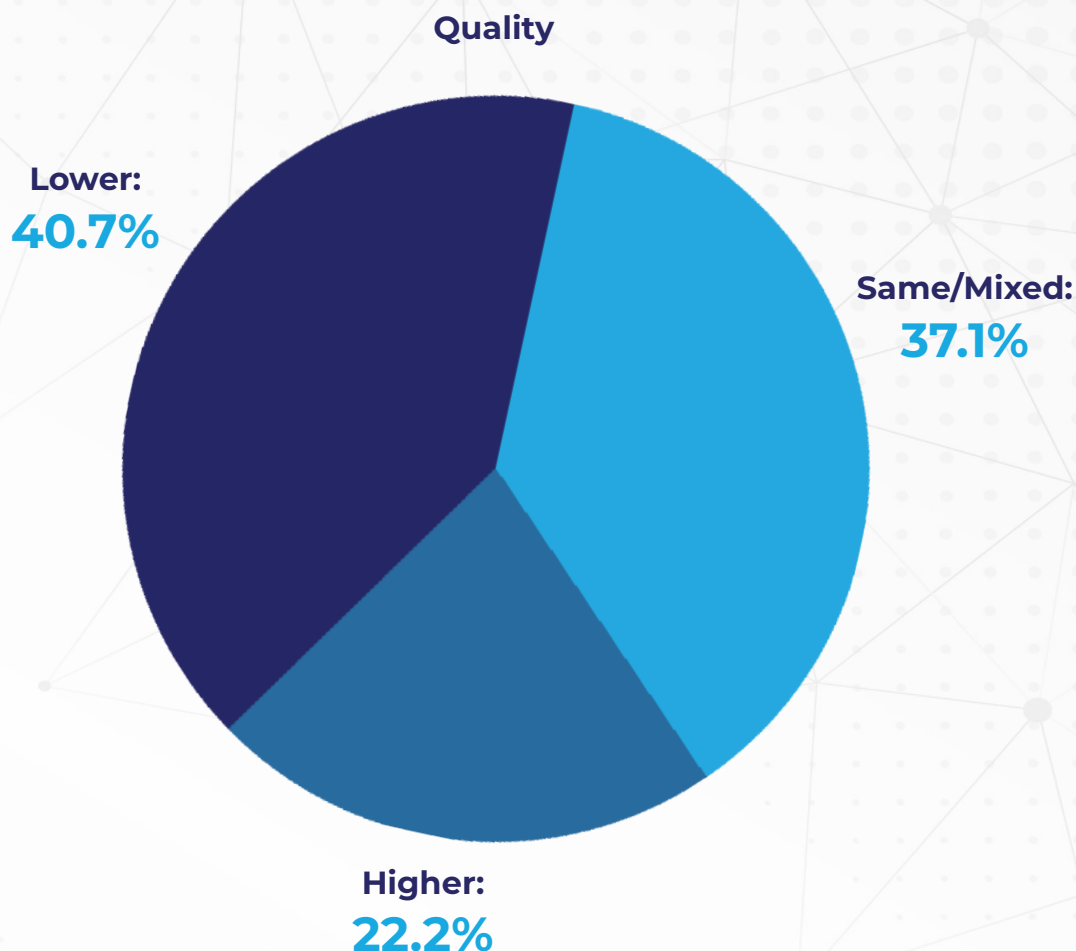
Quantity of deals through the middle-market manufacturing/industrial sector also appears to vary extensively by subsector. When it came to a question of higher versus lower quantity, respondents were divided, with 11 rating quantity as growing or higher, 13 rating quantity as lower, and 4 respondents stating that they felt it was the same as pre-COVID-19 levels. Carolina Hensley says that there are “more deals, but they specifically resulted from our extensive efforts,” which refers back to Opus Connect’s previous query on the challenges faced by professionals operating in this current deal pipeline.

Several respondents also referred to the outcome of the 2020 election as an indicator for quantity, as the research for this report was conducted prior to the first week of November. Dan Lebeck in particular states that he thinks “there are going to be a lot of deals after the election. A lot of pent-up deals are planning to go to market at Q1 next year.”



Question 8.3: How do you see the state of your new deals in terms of quality?

As with the previous question, the responses to this second part will also vary by subsector, and the data supports the diversity of our respondents. Out of the 27 responses provided for this question, the results were split among better quality (6), lower (11), the same/mixed (10). Ashley Kooyenga notes that quality is “a lot more competitive, which is driving pricing up.” Greg Foy states that quality has “largely help up” to pre-COVID-19 levels, but the varied nature of the responses demonstrate that there is still a great deal of uncertainty in the market.



F. MARKET STATUS

Question 9: How do you deal with COVID-19-related EBITDA adjustments?

The survey participants provided a range of answers for this question, since there are many factors that can impact estimating EBITDA and it also varies based on industry. Instead of summarizing the answers, it is perhaps more insightful to read what the respondents had to say in their own words, as follows.

Christian Lund: We look at COVID-19 adjustments the way we look at any adjustments, but we are not accepting revenue or margin adjustments related to COVID-19. For us, the business is performing at the level its performing.

Dave Krasne: The same way we look at other adjustments – by asking what the steady, normal operating state of the business is; we would not accept add backs.

Greg Foy: We take a very, very careful view of COVID-19 add backs and adjustments in making our investment decisions. So far in the three deals that we closed during COVID-19, none underperformed.

Michael Arguelles: We are giving some implied improvement; we are giving adjustments some value had COVID-19 not happened; there is no straightforward mechanism right now.

Steven Morgenthal: It depends; if the company is temporarily positively impacted, they will be looking at things like earnout; on the other hand, if it is negatively impacted and temporary, we're looking for proof that it is temporary and we're looking at earnouts and other techniques to try to bridge valuation gaps.

Question 10: How do you see the state of the debt market?

Responses to this query fell along several lines of thinking, with eight respondents mentioning that lenders were still active but not as many banks were taking part in the debt market, and six respondents feeling that the debt market was more conservative, with “anxiety in the market,” as Dan Lubeck posits. Bill Wilkins states that there is “availability on smaller deals- highly competitive rates; ABL continues to be competitive; there are more lenders that are willing to help.” Several others noted that the answer to this greatly depends on the company in question, while a few respondents had no issues with debt availability or work on small deals and do not have to face this issue. A few stated that the debt market “remains strong” or is improving, even to the point of stating that the market is competitive.

Regarding this area of business, Chris Sheeren stated that “if you have more assets in terms of getting a deal financed, you are better off now than with purely a cash flow deal. Compared to three or four months ago, banks’ portfolios are more under control.”

Question 11: What do you think will be the biggest trend in 2021 and its impact on deal markets?

The outlook on 2021 trends was mixed, reflecting the overall uncertainty faced by the manufacturing and industrial sector as the world progresses out of the pandemic mindset and looks forward to what they hope will be a better year. Several respondents expressed the hope that the “deal flow could come back,” with Brent Johnstone pointing to the upward trend of technology in all spaces, predicting that “the continued use of data and analytics in the industrial space” and “use of Artificial Intelligence” would be the biggest trends in 2021.

Ashley Kooyenga suggests that “supply chain is going to be the biggest trend,” and Mike Andrews also advocated closer attention to the global supply chain, which seems to relate to the promising reports of a vaccine giving a boost to all related manufacturing/industrial sectors. Chris Sheeren’s statement supports this, noting that “hopefully, confidence will increase in the debt market, especially when the vaccine for COVID-19 is provided.” Mark Jones’ statement also reflects a world changed by COVID-19, stating that an “e-commerce strategy is highly in need for the next years to come,” with the implication that the

manufacturing/industrial sector should pay specific attention to digital and technology trends.

Edward Crawford has a more pessimistic prediction, stating that “I think a lot of aerospace manufacturing will be really hurt; we are seeing a lot more action in industrial automation” for 2021, and several others anticipating a slower economic recovery that could last until 2023 or later. Steven Schwartzman mentioned the impact of the 2020 election on such predictions, telling Opus Connect that “this really depends on who wins the election. We could be seeing more on green, renewable energy and efforts to subsidize that or we could see more tariffs, more intervention on the movement of goods and services.”

RESULTS ANALYSIS

While the middle-market manufacturing/industrial sector has seen challenges and issues from the COVID-19 pandemic in the form of slowed deal flows and less deals overall in 2020, there is an uptick in certain areas of the deal pipeline. Management teams are scheduling more in-person meetings as travel resumes, deal professionals are growing a bit more comfortable with virtual environments, and deals are happening with greater regularity as 2020 winds down. As expected, some companies in the manufacturing/industrial sector were hit harder by COVID-19 than others, with divided responses on challenges surrounding due diligence, debt financing, portfolio sales, and more.

Professionals in this sector are still almost entirely wary of conducting business with virtual tools, preferring to meet in person and demonstrating their unwillingness to close new platform deals without spending as much quality time with management as possible prior to closing. Add-ons are a bit more flexible, but doing business virtually still leads to uncertainty from deal professionals.

The state of new deals – pricing, quantity, and quality – has fluctuated for some in the manufacturing/industrial sector but remains steady in others, which presents opportunities for those looking to expand their deal pipelines as we head into the end of 2020 and the beginning of 2021.

In terms of forecasting 2021, the mixed nature of responses only serves to underscore the tumultuous times that 2020 and all its attendant crises have created on a global scale, and not just from the pandemic and the hopes for manufacturing and distributing a vaccine for millions of citizens around the world. US politics and the 2020 election have a demonstrable impact on the way markets and sectors will trend in the coming year, causing market fluctuations and shifting predictions as to what the coming years have in store from a deal flow perspective.

In closing, uncertainty reigns and the manufacturing/industrial sectors remain cautious about growth at the moment, preferring to take a conservative approach as deals move forward and the markets look to 2021 to improve upon the current landscape.

INDEX OF CONTRIBUTORS

Dan Lubeck, Managing Director at Solis Capital Partners, LLC

Mike Andrews, Founder, Managing Partner at Hawkstone Capital

Greg Foy, Director at Mezzanine Partners

Christian Lund, Partner at HRCP

Mark Jones, Partner at River Associates

Tom Remien, Managing Director at Northeast Aquisitions LLC

Nick Russell, Partner at Tuckerman Capital

Michael Arguelles, Managing Director & Business Development at Stonehenge Partners Inc

Steven Swartzman, Co-Founder at C3 Capital

Edward Crawford, Co-Founder & President at Coltala Holdings

Jose Blanco, Managing Partner at CVF Capital Partners

Jonathon Saltzman, Managing Director at Torque Capital Group

Anthony Manzo, Principal at Cannon Capital

Chris Sheeren, Partner at Longhouse Partners

Michael McTague, Senior Vice President at Able Global Partners

Greg Klein, Co-Founder & Managing Partner at Tartavull Klein Capital LLC

Nicholas Janneck, Principal at Vance Street Capital LLC

Brad Scholtz, Scott Capital

Samantha Ory, General Partner at Ouroboros Group

Dave Krasne, Founder at RedNest Partners

Carolina Hensley, Principal at Progress Equity Partners, Ltd

David Mack, Principal & Managing Director at Pathfinder Group LLC

Steven Morgenthal, Managing Director & Operating Partner at Argosy

Brent Johnstone, Managing Director at The Quarry Capital Team

Adam Zacuto, Vice President at Century Park Capital Partners

Tom Courtney, President & Managing Director at The Courtney Group

Bill Wilkins, Founder & Managing Partner at MSI Team

Ashley Kooyenga, Director of Business Development at McNally Capital

Jim Bloom, Founder at Vopne Capital

Bud Moore, Managing Partner at Valesco Industries

Mario Maselli, President & Managing Partner at Upper Bay Infrastructure