

Advanced Manufacturing

An Interview featuring FOCUS' John Slater and Jorge Maceyras



An Interview with FOCUS Investment Banking ("FOCUS") our M&A Worldwide Partner in the US

M&A Worldwide recently conducted an interview with two bankers from FOCUS Investment Banking to gain insight into the practice and workings of the Advanced Manufacturing sector.*

To give some context on FOCUS, this is one of the headlines from their website:

"With more than three decades of experience, FOCUS Investment Banking is a trusted name in M&A advisory services with a nationwide footprint and a global reach. Headquartered in the Washington, DC metro area, FOCUS also has corporate offices in Atlanta and the Los Angeles metro area. Its team of 39 senior bankers is supported by more than a dozen analysts, senior advisors and support staff. Each FOCUS banker maintains a core practice in one of the twelve industry verticals comprising the firm's current areas of specialization, keeping FOCUS abreast of developments in today's rapidly changing market environments."

In terms of Advanced Manufacturing, FOCUS Investment Banking believes that the global economy is at an inflection point. We are in the early stages of an automation and digitization boom that promises to fundamentally transform the global manufacturing and distribution industries. Companies that don't adapt are at significant risk of being left behind.



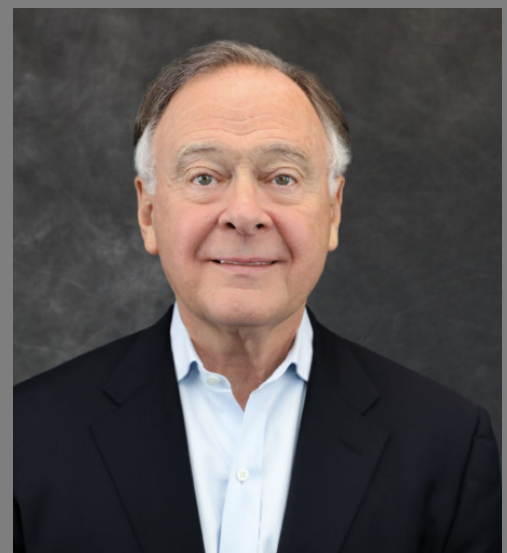
Firms in the Advanced Manufacturing, Distribution Logistics and Automation industries operate in a rapidly evolving environment. The capital markets have taken notice, and aggressive, well-funded acquirers are rapidly transforming the competitive landscape.”

Late last month we held a Q&A session with John Slater and Jorge Maceyras, two of FOCUS' Managing Directors in the Advanced Manufacturing sector. The following is a synopsis of their remarks:

FOCUS created a team four years ago now, called Advanced Manufacturing & Automation (AMA), defined to include the precision machining industry. M&A Worldwide created a similarly named industry group a short while after that. The vision for this practice came when they had the good fortune of closing a deal in 2015 of a company that was building parts for robotic weapons guidance systems and missile components, a very precise and sophisticated part of the precision machining industry.

John Slater explained he had worked in a metalworking shop, a very loud and dirty environment at that time, so when he got to see what a modern precision machining company was like, it was eye-opening for him. Basically, they used what we know generically as a CNC (computer numerically controlled) machine to automate the production of incredibly high precision components. They operate with precision down to about 10 thousandths of an inch on some of the parts required. On occasion, they go to micron precision. They're also beginning to use robots to load the machines. In essence, the machines themselves are robots.

So what we learned about this industry is that the US has roughly 18,000 small to medium companies in the space. Among these, maybe 2,500 companies are of a size and scale large enough to generate interest from consolidators. A few years ago, there was little interest in this sector, with only a few private equity groups trying to acquire these types of companies. Initially, we noted this interest in consolidation while running a complex process for a family owned company (Project Crimson) that attracted about 50 NDAs and came down to two serious competitive bidders. We ultimately sold Crimson to Arch Global Precision. That was just the beginning of Arch's process of aggressively consolidating the precision machining industry in the US with 29 acquisitions to date.



John Slater

If you fast forward to today, six years later, FOCUS recently took to market a company (Project Orbit), which makes high precision parts for satellites. They built a part which helped the satellite send down a vehicle to land on asteroid Bennu, to take soil specimens and bring them back to Earth. Interestingly enough, they also have had one of their parts installed on Perseverance, the Mars Rover.

As an indication of how far the market has come since 2015, we were able to create a target list of 375 prospective buyers with relevant investments or experience in machining and contract manufacturing that we reached out to and received 91 NDAs. We ended up with 19 indications of interest, seven of which were sufficiently serious that we set up management calls. Finally, there were three formal LOI's at the high end of our valuation range. This shows it's a hot market; along with this deal we will have closed 13 transactions in the metalworking sector. We have at least three more active transactions right now, at various stages, engaged on the buy or sell-side.

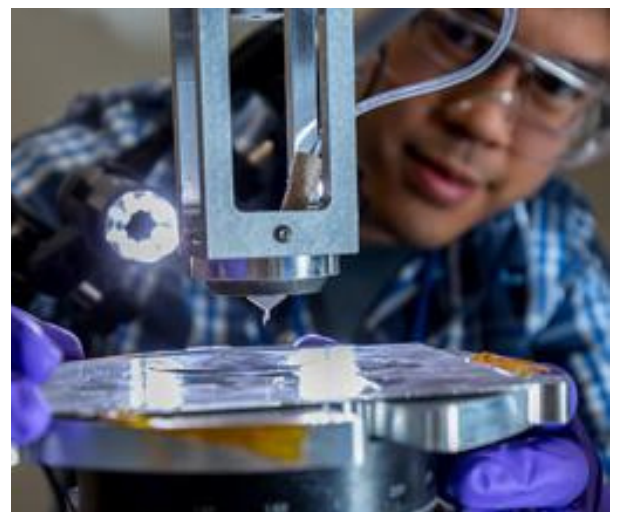
We also have another buy-side assignment in the cutting tools segment, which is an important part of metalworking. This leads us to believe that this industry, at least in the US, will continue to consolidate aggressively.

We are encouraging the M&A Worldwide AMA Industry Group to figure out if there's a similar dynamic in Europe. We can't imagine that they do not have similar dynamics, at least in some of the markets. Germany is the most likely to have a similar dynamic, but probably Italy and Switzerland as well, both of which have a significantly large precision metalworking industry.

In the US, there are two or three main factors pushing for consolidation. One is, there are a lot of companies that were started 30-50 years ago. In many cases, the owner is at a point, maybe in their sixties, where they are ready to make a decision, either to pass it on to the next generation who are possibly not interested in that kind of labor-intensive work, or to team up with a consolidator to support growth and enable the owner to realize the value he has created. The reality is a lot more capital has appeared and so valuations have gone up.

There are industry dynamics that are driving larger companies which have a competitive advantage. These companies would typically sell to the world's largest medical device manufacturers, or aerospace and defense manufacturers, multi-billion-dollar companies. What we've learned from COVID, has really been a wake-up call for lots of people. Supply chain resilience is a watch word, and if you're a \$9 million company that is making specific parts and your parts are not delivered and installed, the satellites are not launched. Customers increasingly can't take the risk of depending on these very small companies, no matter how good they are at what they do. So there's a customer side dynamic that's going to help force the consolidation of the industry too.

We also think that there's increasing capital pressure. These machines are extremely expensive, and the technology continues to evolve rapidly. If you're talking about the lower end, typically these companies are spending hundreds of thousands of dollars to buy a mill but could just as easily spend over a million dollars on a single machine. They are obviously successful, and they've become very comfortable financially but still writing a million-dollar check gives you a lot to think about.



In the case of Project Orbit, one of the main drivers is that our client, the sole owner of the company, felt that the company needed to be part of something larger to give his team the opportunity to continue to grow. They were highly motivated at his company to sell to a truly outstanding bigger company doing a consolidation play in the industry in which he could enhance his and his teams' career opportunities. He doesn't have any particular interest in just cashing in and going to the beach; he's excited about getting up every day and making parts and being a part of projects that are very successful.

We've realized that there is a global opportunity and not just in precision or highly engineered metal parts, which is what we've mostly been focused on so far. A variety of precision manufacturing elements lie within the supply chain: electronics manufacturing, various polymer, injection molding companies and other types of advanced polymer and composite materials, ceramic materials etc. They are primarily more chemical companies in nature but do very specialized work.

This is changing the industry; we're going to see new additive manufacturing and other advanced digital manufacturing technologies dramatically change the way things are made, automating a lot of what has traditionally been craft trade. Even a CNC machine has to be programmed by skilled labor, however, so the human element will not disappear.

The machine has to be made functional, even though it's got lots of digital capability. But more and more, we're heading towards a world where there's an engineer, sitting at a desk and designing a product where you will be able to push a button and the system will allocate the best way to get this made. Artificial intelligence (AI) tools will send instructions to robots all over the world to make the parts or make the products, and so that's the other piece of our practice. We are working to build a practice to say what will be the future of all of this.

We recently recruited as a senior advisor a former executive of Jabil Inc. (NYSE: JBL), a global manufacturing services company with operations in 30 countries and over \$26 billion USD in revenues, someone with tremendous knowledge and experience to help us better understand the breadth of this whole opportunity, which is going to entail a lot of consolidation and change in the way products are made and delivered.



Jorge Maceyras

Project Orbit is just one example which shows that private equity has gained a new appreciation for manufacturing services. In general, private equity historically has been reluctant to invest in the space because of the capital-intensive nature. Not only that, typically many of these companies don't have a lot of what would be considered traditional intellectual property. They don't necessarily have a brand or patents, and what kept investors away was that sales were often project-based. Private equity prefers sales that are more frequently recurring in nature. I think they're realizing that in fact, there is a lot of intellectual property in what they call tribal knowledge, ie. how to make something very difficult, very hard to assemble, that's very complex. Just because there's not necessarily a patent behind it, if you can do it very well, you're going to get repeat business, very often from the same customers, even if it's not contract-based.



**M&A Worldwide is a leading mid-market M&A advisory practice, comprising 433 professionals in 36 countries to bring professional M&A services to clients across the world. M&A Worldwide conducted this interview and published it on their website on June 18, 2021.*