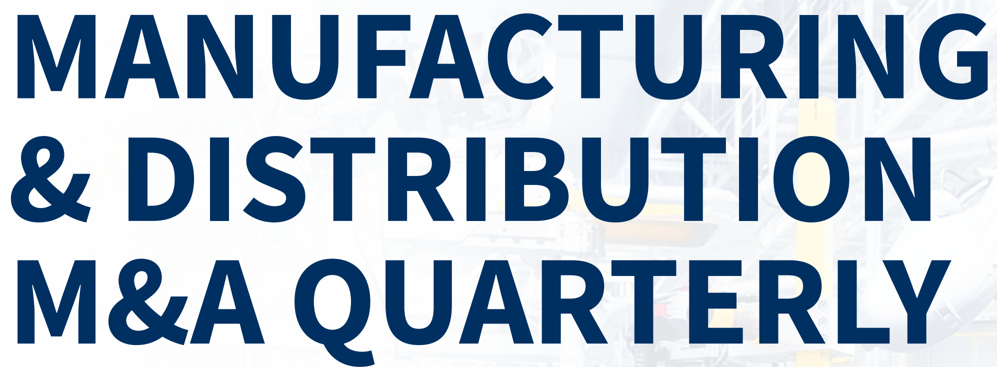

MANUFACTURING & DISTRIBUTION M&A QUARTERLY

Q2 2024

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MANUFACTURING & DISTRIBUTION M&A QUARTERLY: Q2 2024

By Helana Robbins Huddleston, Tara Marino, and Kim Clark Pakstys

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The majority of M&D deals that closed last quarter focused on debt financing, but there were also some bright spots that should continue to gain momentum during the second half of the year including investing from venture capital and some larger transactions closing as discussed below.

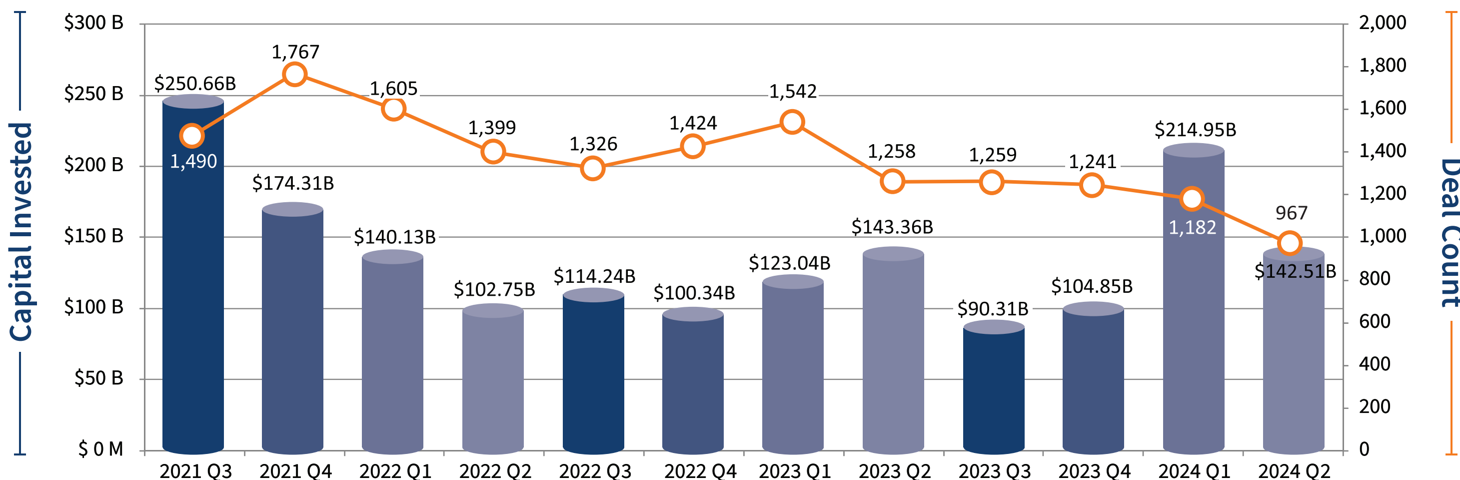
We also noted despite the pullback on total deal count during Q2, the capital invested during the three-month period of $142.51 billion was on par with the same period in 2023 of $143.36 billion. Fewer number of deals but similar capital outlay drove the average deal size higher – a trend existing for the past 12 months. Additionally, of the top 10 M&D deals that closed, approximately 70% were billion- dollar debt refinancing deals for Fortune 500 businesses. However, we are also seeing a similar refinancing trend with middle-market companies.

Looking ahead to Q3, we do expect investments and acquisitions to pick up as sellers are preparing for market and intending to launch in early-Fall. There also still remains a significant amount of capital that needs to be deployed, as well as a return of capital to limited partners in order for private equity funds to have successful fund raising in the coming years.

QUARTERLY TRENDING NUMBERS

All data gathered from PitchBook Data, Inc., as of July 11, 2024

Capital invested by deal count



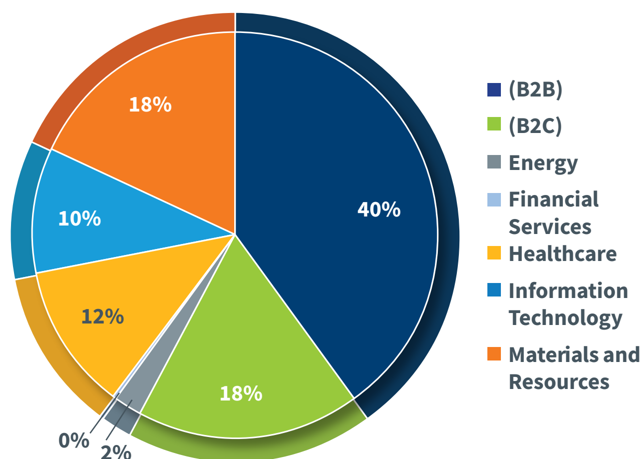
The second quarter of the year saw a total of 967 deals closed for a total of $142.51 billion invested in the M&D market. This compares to $214.95 billion across 1,182 deals during the previous quarter, and $143.36 billion for 1,258 deals during the second quarter of 2023.

The biggest deals of the quarter included a large number of debt financing deals, many of which were Fortune 500 businesses such as Boeing, Johnson and Johnson, and Coca-Cola, but other middle market to larger businesses were also in the mix; We saw Culligan International, Gardner Denver, and Medline Industries complete debt refinancings.

Q2 2024: Top 10 manufacturing and distribution deals

Company	Deal Date	Deal Size (Millions)
Boeing (NYS: BA)	29-Apr-2024	10,000
Coca-Cola Consolidated (NAS: COKE)	10-Jun-2024	6,300
Ingersoll Rand (NYS: IR)	06-May-2024	5,900
Mks Instruments (NAS: MKSI)	26-Jun-2024	5,154
Culligan International	07-Jun-2024	4,759
Johnson & Johnson (NYS: JNJ)	13-May-2024	4,000
Gardner Denver	07-May-2024	3,300
Coca-Cola (NYS: KO)	06-May-2024	3,000
Endo International	11-Apr-2024	2,900
Medline Industries	06-Jun-2024	2,690

Q2 2024: Capital invested by primary M&D sector



Top private equity investors that closed deals during the quarter included Platinum Equity, Wynnchurch Capital, and ACE & Company while venture capitalists also came back into the market with Plug and Play Tech Center, Climate Capital and Techstars closing eight, six and four transactions, respectively. Some noteworthy M&D acquisitions during the quarter included AMPHENOL acquisition of Carlisle Interconnect Technologies, a subsidiary of Carlisle Companies for $2.025 billion on May 21, 2024. The acquisition enhances Amphenol's product offerings for highly engineered harsh environment interconnect solutions and will enable it to deliver a more comprehensive technology offering for our customers in the commercial air, defense, and industrial markets. Resideo Technologies also acquired Snap One Holdings Corp for $1.4 billion on June 14, 2024. With this acquisition, the two businesses will provide integrators with an increased selection of both third-party products and proprietary offerings through an extensive physical branch footprint augmented by industry-leading digital capabilities.

As it relates to investing by category, the B2B sector comprised the majority (40%) of M&D deals during Q2 with $56.67 billion invested, and B2C comprised approximately 18% of the total deal volume for a total of $25.87 billion. Materials and resources deals came in around $26.03 billion, followed by healthcare at $16.64 billion and IT at $14.26 billion.

MARKET FACTORS IMPACTING 2024 M&A

It is no secret that deal volume is down across the board, with M&D experiencing repeated declines in activity this year particularly compared to 2021, when Q3 saw nearly 1,500 deals close. It has been a tough year so far for the markets, which entered 2024 hopeful that inflation would be curtailed and interest rates would begin to come down. We have heard recent positive news on inflation with the Consumer Price Index declining 0.1% in June, the first decline in consumer prices since the pandemic. With a slowing inflation, we are hoping that will drive a clear path for the Federal Reserve to begin a reduction in interest rates possibly starting in September.

We continue to see a longer close period on transactions and even more M&D deals fall apart as the current market volatility can make it extremely challenging to make proper operational decisions and earnings projections. At CohnReznick we are managing more sell-side transactions than we saw last year, which is a strong indication that the transaction market will become active. We are also being asked to continue to roll forward the monthly financial information, which shows there is a delay in going to market. Clients and their investment banks are leaning towards a launch after Labor Day in hopes that some of the market volatility and uncertainty has waned by that time.

As the M&D sector continues to face some persistent headwinds including inflation, high interest rates, tariffs, and stressed labor market conditions, there are also several areas that companies are pursuing as they come up with ways to address the roadblocks.

- **Reshoring and nearshoring of both production and sourcing:** U.S. manufacturers are bringing both back home; moving production capabilities and sourcing materials closer to home and looking at Mexico and Canada as potential targets for these realigned facilities and material sources.
- **Automation and AI:** The online selling boom is here to stay, and we are seeing distributors invest in more efficient, automated fulfillment centers, including solutions that help streamline the picking, packing, and shipping process in this era of ultra-fast delivery expectations. Businesses are also embracing digital technologies like AI, IoT, and data analytics to better manage production, inventory management, and forecasting. We are seeing sales and back-office functions explore, pilot, and adopt automation and AI solutions as they become embedded in productivity software, and Microsoft and Google applications.
- **Sustainable M&D:** While ESG may be a challenge to companies, it's also helping those that prioritize it by using recycled materials, reducing their greenhouse gas (GHG) emissions, and using electric delivery vehicles to cut down on emissions. These are all things customers have come to expect from the companies they buy from.
- **A bigger emphasis on workforce training and support:** Distributors that once were able to just pluck experienced employees out of the labor pool are getting more creative with both recruiting and retention. One good strategy is to invest in workforce development programs, including apprenticeships, cross-functional training, and other on-the-job training to attract and retain workers in this constrained labor market. Numerous cities and states are providing money for workforce training, tuition grants for employees, and skill matching or intern programs to address workforce issues and upskill or reskill regional workers.

WHAT'S NEXT?

Looking ahead to Q3, we do expect the M&A market to pick up as sellers are preparing for market and intending to launch in late summer or early fall. Several publications covering the M&D market share an equally optimistic outlook for the next six to 12 months. For example, **PE Weekly** sees available opportunity in the custom aerospace parts, magnets, and optical components markets. These specialty production markets dominated a Q2 acquisition list developed by private equity firms and strategic buyers, says PE Weekly. Even so, we don't expect enough activity and deal closures in FY24 to make the activity level exceed FY23.

A SELLER'S GUIDE TO PRE-M&A PREP (and the first 90 days that follow)

While the current market conditions present some interesting challenges for buyers and sellers, deals are still closing. We wanted to share some of the strategies that are working best in these circumstances.

As a whole, M&D companies tend to be more capital intensive, which is a key area discussed during the due diligence process. The condition and ownership of any real property; the capital expenditures required in the near-term; and any lease accounting (ASC 842) considerations are a few of the areas that buyers will be reviewing. M&D companies are usually well positioned for these inquiries when obtaining tangible property appraisals for asset-based lending purposes. However, they also tend to have complicated procurement, inventory, cost accounting, and asset management issues that should be addressed before due diligence. Having a solid finance function foundation is critical and, without it, founders limit sale price or spend time and money in diligence proving the numbers.

Maximum value, minimum hassle

During sell-side due diligence, the period when a seller is preparing for a transaction and receiving support from an experienced transaction team, if you are operating a capital-intensive company, it is prudent to begin the appraisal process for any tangible property, before the transaction closes. Once acquired, the target company typically will have to produce audited financials for the new investors and/or lenders post-close. For financial reporting purposes, when a transaction occurs resulting in a change in control, the purchase price paid must be allocated among the assets acquired. This includes any existing assets that are not included on the closing balance sheet, plus any assumed liabilities at their acquisition date fair values. This requirement falls under accounting standard codification ASC 805, Business Combinations, which requires that the Day 1 opening balance sheet reflect all assets acquired and liabilities assumed at their acquisition date fair values, often referred to as the "purchase price allocation" for financial reporting purposes.

Depending on the transaction structure, certain transactions will result in a step-up in the tax basis of assets acquired for tax purposes. As such, for capital-intensive companies, the fair market value of the tangible property could be material to the "tax purchase price allocation" (for example, filing tax form 8594 under IRC Section 1060, Special Allocation Rules for Certain Asset Acquisitions). Since both the buyer and the seller need to agree to this tax purchase price allocation (as referenced in the purchase agreement, as applicable), it is yet another reason to get a head-start by obtaining an independent third-party appraisal of any real property or personal property during the deal process and prior to the transaction closing.

The term "purchase price allocation" is often used interchangeably for both tax purposes (e.g., IRC 1060) and for financial reporting purposes (e.g., ASC 805), but there are differences; therefore, it is important to understand the different requirements before the deal closes. Accounting, tax, and advisory professionals, including a valuation specialist, can help you navigate through the complexities of the various reporting requirements and related analyses needed in connection with an acquisition.

Purchase price allocations can be viewed as more than compliance, providing investors and stakeholders with transparency into what was acquired and what would otherwise not have been reflected on the balance sheet, including intangible assets such as patented or developed technology/IP, contract backlog, customer relationships, brand, trademarks and trade names, non-compete agreements, and above or below market real estate leases. In addition, any purchase consideration in excess of the fair value of net identifiable assets acquired (tangible and intangible) is allocated as residual goodwill, which is assessed for impairment at least annually, or in between annual testing periods upon the occurrence of a triggering event (i.e., an event occurs or circumstances change that indicate that the fair value of the entity may be below its carrying value). For private companies or not-for-profit entities that have made an accounting policy election to apply the accounting alternative for amortizing goodwill, impairment triggering events only need to be evaluated at the end of each reporting period. This provides more transparency into the actual performance of an investment and increases management accountability for continued performance of the business post-acquisition.

Companies that get their financial statements in order, avoid shortcuts, do their valuations properly, and conduct their purchase accounting the right way can avoid issues with their overall financial reporting. Those that ignore these steps will only have to go back and make retroactive adjustments and corrections.

Preparing for day two and beyond

Once the transaction closes, the buyer has complexities to consider including aligning functions and reporting; ensuring that acquired firm's financials are in order, are compliant, and are recorded consistent with the buyer's; and that synergies and efficiencies of scale are put in place. Leases, talent, corporate culture, future growth strategies, technology systems, and reporting processes all must be aligned and/or integrated with the acquirer's operations.

Here is where all the planning and data collecting that happened during the due diligence and integration planning really pays off. Having all this information can help the new owner be successful in the first 90 days; This is particularly true for M&D where organizations are not necessarily known for their sophisticated business processes or technology systems. The acquired company will need to shed the bare bones of disparate applications and immature processes. To scale and reap the returns, the acquired company must be onboarded to the new processes and systems which often include an enterprise resource planning (ERP) system that enables transparent, real-time, accurate reporting. Sellers can expect growing pains through this transition as they will need to learn new processes and adopt new work cadences in addition to new systems.

Within the first 30 to 60 days, the acquirer will really "get under the hood" to assess the accuracy of the due diligence data. With little time and limited data, expect 20-30% accuracy at best, based on our experience and recent conversations with investors. The better the data and upfront planning, the easier the transition. But the deal team is driving the transaction and often doesn't include the implementation/transition or operating teams until right before close. It's very important to set expectations across the business with respect to cadence, reporting, decision making, authorities, and governance in the first 30 days. Ensure that the execution/integration team understands the deal thesis and plans for integration, optimization, and hold period. This information will shape and drive value creation activities, and help establish culture and assist with retention of key talent.

This is also the time to think about integration strategies: Will the company operate as a standalone entity or will it be added into a larger group of existing companies? Will this factory or distribution center be used as a transaction accretive to revenue, to obtain an additional footprint, or to be integrated into the brand? Regardless of which direction is selected, having consistent communication around practices, and alignment of policies and practices to help ensure consistency, will be very important during the first 90-day period.

Finally, be sure to factor in any cybersecurity threats or privacy issues that the new company may introduce. Identifying and addressing these threats should be part of the initial due diligence process, but as things change quickly, and new information and threats arise, review the diligence input against the records as part of the initial onboarding process. This will help ensure a smooth transition and identify risks from the transaction.

FOOD MANUFACTURING M&A ACTIVITY

The food manufacturing sector was active during the second quarter and much debt was refinanced during the three-month period. Deals of note included Anchor Packaging's $790 million dividend recapitalization, and the acquisition of Corbion's business division by Kingswood Capital Management for $362 million. Debt refinancings occurring in Q2 included Coca-Cola Consolidated with a $6.3 billion debt raise, Lamb Weston Holdings receiving $450 million of debt, McDonald's closing on $2 billion of debt, and United Natural Foods refinanced $630 million in debt.

Similar to the overall M&D market, we have also seen renewed interest by venture capital investors in the F&B industry. The top investors in the food and beverage space for the past six months in 2024 are heavily weighted towards venture capital with a few private equity deals getting completed. In the past six months, Gaingels completed six transactions, Plug and Play Tech Center completed five transactions, Branch Venture Group closed three transactions, Ackley Brands completed three transactions, and Encore Consumer Capital closed two transactions.

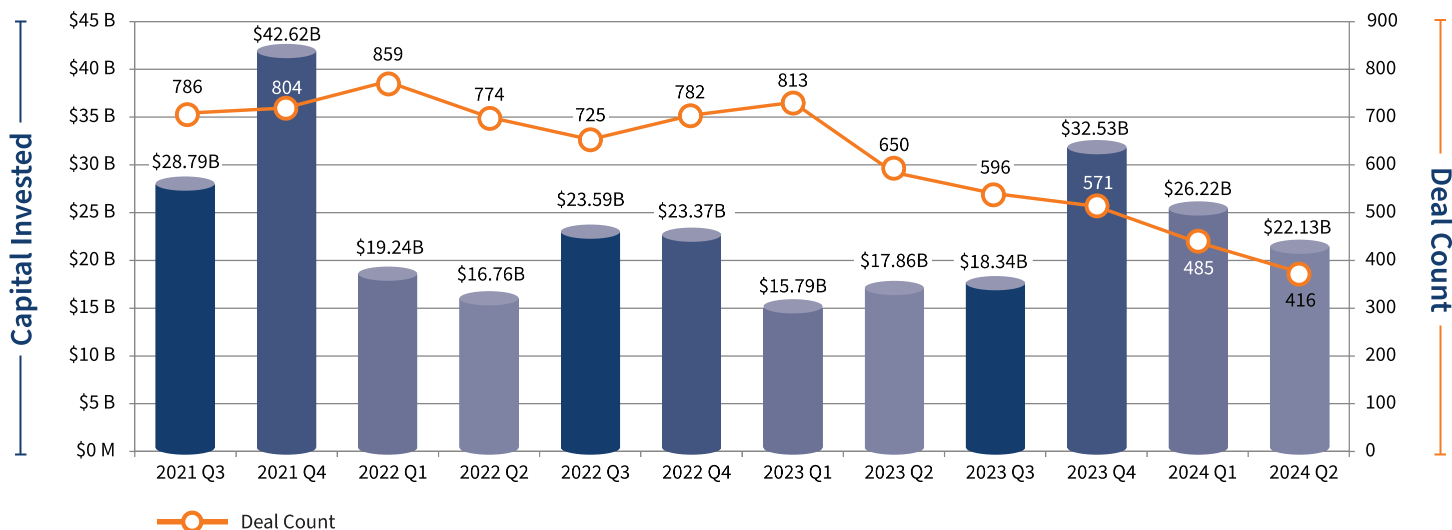
We are seeing geopolitical impacts on the supply chain in the form of access to raw materials, wars, and recurring supply chain disruptions. New laws, acts, and regulations (e.g., IISA, IRA, CHIPS Act, etc.); the persistent labor shortage; the drive to automate and digitalize; and increasing cybercrime levels are also impacting the food manufacturing sector.

As they work to scale up, maintain a competitive advantage, and meet delivery capacity, issues like the higher costs of doing business and rising labor costs will continue to drive M&A and consolidation in the sector.

QUARTERLY TRENDING NUMBERS

All data gathered from PitchBook Data, Inc., as of July 11, 2024

Food and beverage manufacturing capital invested by deal count



KEY FOOD TRENDS TO WATCH

The food manufacturing space as a whole is bursting with energy and innovation right now. Specialty Food Association's Summer Fancy Food Show served up some of the newest and best in specialty food and beverages, and attracted thousands of manufacturers, retailers, buyers, brokers, and many others driving the industry. The show featured many live demonstrations and a huge focus on freshness, flavor, and color (the blueberry and blood orange cheeses were a must try!).

We also saw a lot of pizza, pasta, and pasta sauce at the show this year, which is to be expected given that the category is up 17.5% in dollar volume and 6.7% in unit volume year-over-year (2022 to 2023). According to SPINS/SFA, the market for pasta and sauces grew over 30% from 2021 to 2023 and is the top fastest-growing category after eggs – not that surprising considering how many more consumers want pantry-stable options that they can cook at home.

Food makers are also coming out with more colorful, sustainable packaging and removing plastic in favor of more environmentally friendly packaging options. The focus on branding has also returned as more people buy based on their support of the company's actions and what those organizations represent. At the show, we heard from the Whole Foods CEO and he commented on Whole Foods' Sourced for Good (SFG) program, which is one channel that more food makers are vying for because it identifies products that are good for the planet, workers, and the communities where those products grow.

Other trends that continue to impact the food manufacturing space include caffeine in more waters and snacks; protein-enhancements in snack foods like chips, bars, and jerkies; regenerative products (i.e., the conservation and rehabilitation approach to food and farming systems); and non-alcoholic beverages that "taste" like alcohol.

It also looks like restaurants are back in full force, which means the sector may need to work a little harder to ensure that they maintain the right balance of food service and retail whenever possible. According to the National Restaurant Association, total spending at U.S. food service establishments will rise 5.4% this year to $1.11 trillion. At the show we heard restauranters talk about entering the retail space and, at times, purposely establishing a different brand from the restaurant so retail product can stand on its own superiority and not create consumer expectations for the product to be exactly like its restaurant version.

Looking ahead, local ingredients and producers will remain in high demand. With over three-quarters (77%) of Gen Z diners and 70% of Baby Boomers willing to pay more for dishes with locally-sourced ingredients, companies are also focusing on how to procure those ingredients closer to home.

CONCLUSION

Most M&D and food deals that closed during Q2 may have focused on debt financing, but with all the preparation that is going on among sellers, investment bankers, and transaction teams, M&A professionals are expecting a lot of deals coming to market at the end Q3 and into Q4. Additionally, if inflation stabilizes and interest rates start falling as early as September, some of the headwinds that have been impacting M&A activity will likely ease and allow for more willingness by both parties to make the deal happen.

Q2 2024: Top 10 food & beverage deals

Company	Deal Date	Deal Size (Millions)
Coca-Cola Consolidated (NAS: COKE)	10-Jun-2024	6,300
Coca-Cola (NYS: KO)	06-May-2024	3,000
Herbalife Nutrition (NYS: HLF)	12-Apr-2024	1,600
Lamb Weston Holdings (NYS: LW)	03-May-2024	1,541
McDonald's (NYS: MCD)	14-May-2024	1,000
Anchor Packaging	07-May-2024	790
United Natural Foods (NYS: UNFI)	26-Apr-2024	630
PATCO Products	02-Apr-2024	362
Dutch Bros (NYS: BROS)	12-Jun-2024	344
B&G Foods (NYS: BGS)	27-Jun-2024	321

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