

BDO CAPITAL MANUFACTURING & DISTRIBUTION

Q1 2017 M&A Review and Outlook

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BDO Capital Advisors, LLC
provides counsel in the areas of:

- ▶ Mergers & Acquisitions
- ▶ Capital Raising
- ▶ Board Advisory

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M&A IN A CHANGING LANDSCAPE

Where do we go from here?

M&D Sector Deal Volume Down, Valuation Multiples Flat

M&A activity in the *Manufacturing & Distribution (M&D)* sector was down approximately 15 percent in 2016. A decline was expected after a record 2015, and amplified by the sluggish economy and a brutal election season, which delayed sale decisions.

Financial buyers made gains in the sector, backing nearly 40 percent of all closings, including platform and add-on investments, in 2016. This figure is up from 34 percent just two years ago.

Election results buoyed M&D investor optimism, given the new administration's commitment to propelling the U.S. manufacturing industry. Although time will tell if optimism is warranted, our M&D Index beat the S&P 500 by more than 2x in the 3 weeks following Election Day.

The average EBITDA multiple in the sector is 9.0x. A buyer valuing a business at this level must bring significant synergies and/or a sound plan to grow profits quickly and dramatically, or ROI could suffer.

Market Spotlight – M&A and Workforce Gap

It's no secret that meeting growing demand without an adequate and skilled workforce is a challenge. Labor concerns are cited by nearly all (97 percent of) manufacturers in this year's BDO Manufacturing RiskFactor Report, and risks related to labor strikes are cited by 66 percent.

To address this problem, business leaders are partnering in greater numbers with community colleges and trade schools to establish apprenticeship programs. With the goal of developing a more skilled and loyal workforce, manufacturers are developing relevant curricula and training materials, as well as building flexibility into shift schedules to foster work/study opportunities. Business owners using these programs are ultimately making their companies more attractive and valuable to prospective buyers when the time comes to sell.

Economic Conditions – Progress Seen

U.S. GDP has been accelerating, registering a healthy 3.2 percent in annual growth in Q3 2016, up from 0.8 percent in Q1 and 1.4 percent in Q2. Economists expect approximately 2.5 percent growth in 2017. The ISM Index for November 2016 shows the manufacturing sector is gaining steam, and the latest jobs data indicates the unemployment rate is at its lowest level, 4.6 percent, in over nine years. Wages are expanding too, up 2.5 percent in the last year, along with consumer confidence, which jumped dramatically after the election, according to a University of Michigan Survey. Barring unforeseen challenges, the U.S. economic landscape should foster an active M&A environment in the M&D sector during 2017.

STATISTICALLY SPEAKING

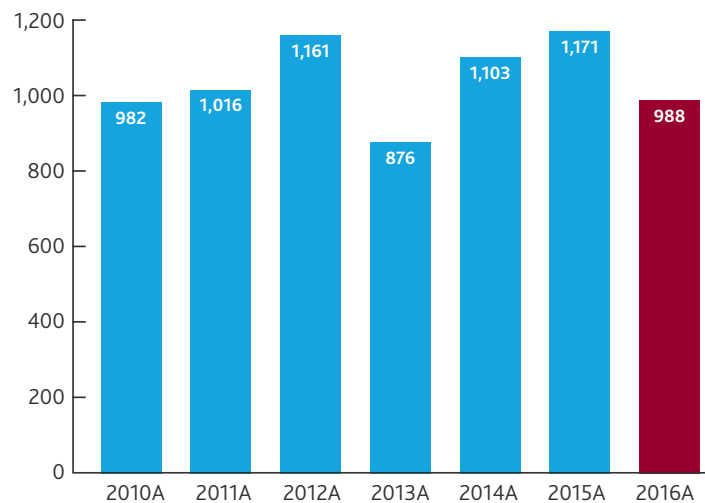
Volumes

Deal volume declined appreciably in the *Manufacturing & Distribution* sector during 2016, down approximately 15 percent from 2015 (see Figure I). While 2015 was a record year for sector closings and therefore tough to surpass, 2016 had the lowest level of transaction activity since the end of the last recession.

Both strategic and financial buyers remained eager to acquire M&D businesses during the year, armed with substantial cash and ample access to debt capital. There were fewer sellers in the marketplace and a slow economy combined with a brutal election season delayed sale decisions. Demand outstripped supply.

When attractive companies did enter the market, buyer competition was often fierce and financial buyers were aggressive. Financial buyers have steadily advanced their share of the deal count in the M&D sector, closing on approximately 40 percent of transactions in 2016, up from 34 percent just two years earlier. This included both new platform and add-on deals.

FIGURE I
Transaction Volumes — U.S. Manufacturing & Distribution
2010A – 2016E

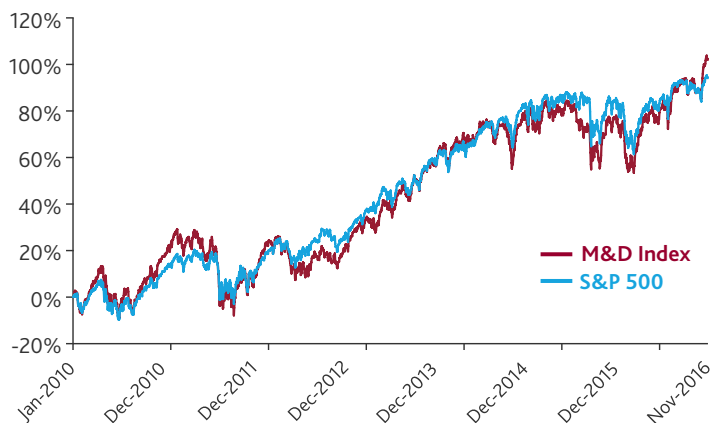


Source: BDO Capital Research and S&P Capital IQ

Valuations

Publicly traded M&D securities have generally trailed the performance of the broader market by a small margin during the post-recession period (see Figure II). Things changed, however, following the national election. Our M&D Index (a basket of over 700 M&D stocks) beat the S&P 500 by more than 2x in the 23 days following the election. While the new administration has a stated focus on enhancing the well-being of U.S. manufacturing, concrete favorable results must follow if investor optimism is to continue.

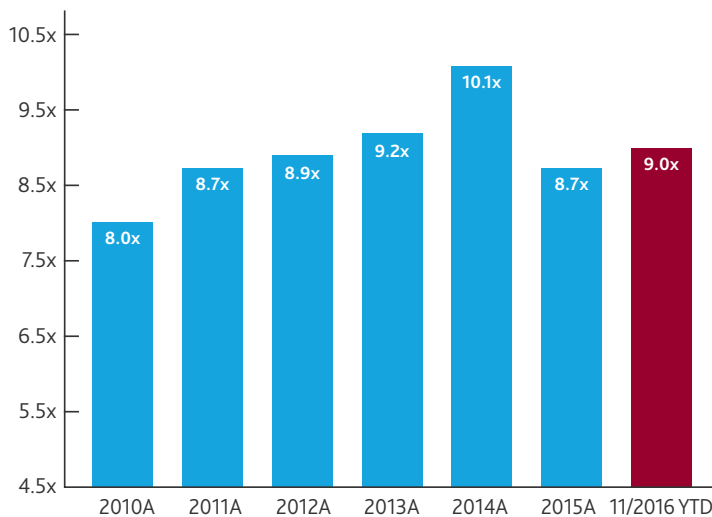
Figure II
Public Company Index — U.S. Manufacturing & Distribution
Jan 4, 2010 – Nov 30, 2016



Source: BDO Capital Research and S&P Capital IQ

Valuation multiples of middle-market M&D companies peaked in 2014 at an average of 10.1x EBITDA (Figure III), when an abundance of strategic and financial buyer interest drove prices up. A combination of factors contributed to the decline in multiples in 2015 and 2016, including economic and political concerns, as well as a broadening mix of companies for sale. More average performing companies sold than high performers in recent periods, driving the average multiple down. A 9.0x EBITDA deal, the current average in the M&D sector, is generally a great valuation for a seller. In a deal of that valuation, the buyer must either bring significant synergies and/or a sound plan to quickly and dramatically grow profits, or risk losing ROI.

FIGURE III
Avg EBITDA Multiples — U.S. Manufacturing & Distribution
Transaction EV of \$500M and Under
2010A – 11/2016 YTD



Source: BDO Capital Research and S&P Capital IQ

MARKET SPOTLIGHT

M&A and the Workforce Gap

With approximately 10,000 baby boomers retiring every day until 2030, and challenges competing for younger talent against tech and other lucrative paths, manufacturers are dealing with shallow labor pools on both ends of the age spectrum.

From an M&A perspective, while buyers pay attention to labor supply and talent in their due diligence, it's rare for shortcomings in this area to derail deals. This is not because the issues are insignificant—it's because the solutions are not easy.

To address these issues, manufacturers tend to grab for tools within reach, but often these tools don't offer long-term solutions. Offering the highest wages in a community is one way to reduce turnover and entice applicants, but not the best way to build healthy profits. Another strategy is to maintain facilities in multiple population centers, thereby reducing exposure to labor pool limitations and the competing hiring needs of other companies in a community.

The "blue ocean" opportunity to build a capable and loyal workforce, however, requires investments in people and communities. Many manufacturers have entered partnerships with local community colleges and trade schools to develop apprenticeship programs. More companies are working with these institutions to develop curricula and training materials, as well as build flexibility into shift schedules to permit students to work machines part-time, make some money, and complement this work with synergistic classroom time. These

programs show young people how interesting manufacturing work is and that, with added skills, it can provide for a steady career with room for growth, advancement and attractive compensation. These factors breed loyalty and extend tenure.

ECONOMIC INDICATORS

The U.S. economy is showing recent signs of acceleration. The recent elections suggest that change is on the horizon with the federal government unified under one party and the market, as measured by stock market performance, seems to be performing well. This increased optimism bodes well for M&A in the near term. Relevant economic indicators include:

U.S. Gross Domestic Product (GDP)

GDP expanded at an annual rate of 3.2 percent in Q3 2016, the fastest pace of growth in two years, driven primarily by stronger consumer spending. Q3 was a significant improvement from the 0.8 percent gain in Q1 and 1.4 percent in Q2, when the economy was held back by a strong dollar and sluggish business investment. That slow growth earlier in the year will likely mean a modest 1.5 percent figure for all of 2016, down from 2.6 percent growth in 2015. Leading economists are projecting around 2.5 percent growth in 2017.

Institute for Supply Management (ISM) Index

The most recent ISM Index shows that U.S. manufacturing activity rose 1.3 percentage points to 53.2 in November, a 5-month high as new orders and production increased. This is a sign that the factory sector is gaining steam as Q4 progresses.

Jobs Report

178,000 net new jobs were added to the U.S. economy in November and the unemployment rate dropped to 4.6 percent from October's 4.9 percent. This is the lowest unemployment rate since August 2007. The year-over-year trend in the labor force is increasing, showing that the labor market is still broadening. Average hourly earnings were up by 2.5 percent. However, manufacturing employment dipped by 4,000 jobs with losses in durable goods industries. Wholesale trade and transportation/warehousing did better, on the other hand, adding 2,800 and 8,900 net new jobs, respectively.

Consumer Confidence

Consumers' initial reaction to the presidential election has been optimistic about personal finances and prospects for the national economy. This optimism resulted in the University of Michigan Sentiment Index registering 6.6 points higher in November than October. This could be a honeymoon period that will only be maintained if the new administration hits the ground running in its first 100 days.

IN SUMMARY

M&D transaction activity has dropped in the last year from an all-time high, in part because of economic and election jitters. Valuations remain high at 9.0x EBITDA on average. Business owners are smart to invest in their employee base through apprenticeship programs, which will ultimately add value to their businesses when the time is right for a sale. The U.S. economy appears to be gaining steam, based on key measures such as GDP, the ISM Index, unemployment, wage growth, and consumer confidence. All things considered, 2017 is ripe for an active year in terms of M&A activity in the M&D sector.

RECENT BDO CAPITAL TRANSACTION

BDO Capital Advisors, LLC, is pleased to announce that Brookdale Plastics, LLC (Brookdale) has been acquired by Placon Corporation (Placon). As the exclusive financial advisor to Brookdale, BDO Capital helped prepare a confidential offering memorandum, contacted an approved list of potential buyers, and assisted the shareholders in structuring and negotiating the transaction, demonstrating BDO Capital's expertise in the rapidly consolidating packaging sector. Brookdale, founded in 1963 and located in Plymouth, MN, designs and manufactures high quality custom medical and retail packaging in the plastic thermoforming industry. Brookdale's 74,000-square-foot facility houses 3-D printers, an in-house tooling department, and a Class 100,000 clean room. Placon, best known for pioneering and patenting clamshell packaging in the 1960s, is a leading North American designer and manufacturer of custom and stock thin gauge thermoformed plastic clamshells, trays, and blisters with an environmentally-responsible line of recycled PET rollstock materials.



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