BDO CAPITAL ADVISORS, LLC
"Trusted Investment Bankers for the Middle Market"

BDO CAPITAL
ENGINEERED COMPONENTS & MATERIALS

Q3 2019 M&A Review and Outlook

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Avista TECHNOLOGIES

Avista Technologies, Inc. and Avista Technologies (UK) Ltd. have been acquired by Kurita Water Industries, Ltd. (TSE:6370)

KURITA

BDO Capital Advisors, LLC served as exclusive financial advisor to Avista Technologies, Inc. and Avista Technologies (UK) Ltd.

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At BDO Capital Advisors, we focus on advising companies that are involved in the design, fabrication, and/or distribution of highly Engineered Components & Materials (EC&M). Our clients in this sector serve many industries, including:

-Aerospace & Defense
-Automotive Components
-Building Products
-Construction Materials
-Durable & Non-Durable Goods
-Electrical Equipment
-Electronic Equipment & Instruments
-Medical Devices
-Specialty Chemicals
-Transportation Equipment

Key Observations:

SECTOR M&A ON THE RISE

Multiples Moderate as Deal Mix Broadens and Economy Softens

Sector Deal Volume Up 20 Percent; Multiples Decline 0.7x

U.S. M&A activity in the *Engineered Components & Materials (EC&M)* sector rose dramatically in the first half of 2019. A Q1 surge eclipsed all but Q4 2012 of the post-recession upcycle. With aggregate deal volume across all industries flat in 2019, the EC&M sector now represents 20 percent of total U.S. M&A, up from 16 percent during the first half of 2018. Private equity (PE) is responsible (in part) for this trend. PE investing in the sector has expanded from 31 percent of deal volume in 2012 to approximately 40 percent in the first half of 2019. Sector strategic buyers routinely lament the competition caused by rising PE interest.

Our EC&M public company index continues to perform similarly to the broader market. Both our index and the S&P 500 are up nearly 50 percent in the last five years. Public investors seem to be finding the EC&M sector to be a good place to invest. Meanwhile, transaction multiples have retreated recently, with the sector's average EBITDA multiple declining 0.7x in the first half of 2019 compared to 2018, to 8.3x. We attribute the decline to heightened concerns about the global economy and a broader mix of companies being transacted.

U.S. Economy Remains Positive, But Has Been Decelerating

Business executives and dealmakers have cause for concern but experts indicate that the likelihood of a near-term recession is remote. As such, both strategic and financial buyers seem generally comfortable with more investing while being attentive to downside risk in their valuations and investment horizons.

GDP expanded by an annualized 3.1 percent during Q1 2019, after growing by just under 3.0 percent during all of 2018. These levels far surpass most other G20 economies, which are generally performing at 0.5 percent growth or lower currently. This contrast, plus the tariff threats, have caused heightened foreign interest in U.S. assets while also raising domestic concerns given the global footprint of most U.S.-based businesses at the moment.

See additional details herein regarding projected GDP and business survey recaps such as the ISM PMI and Small Business Optimism Index, all indicating a moderating of the U.S. Economy in coming periods.

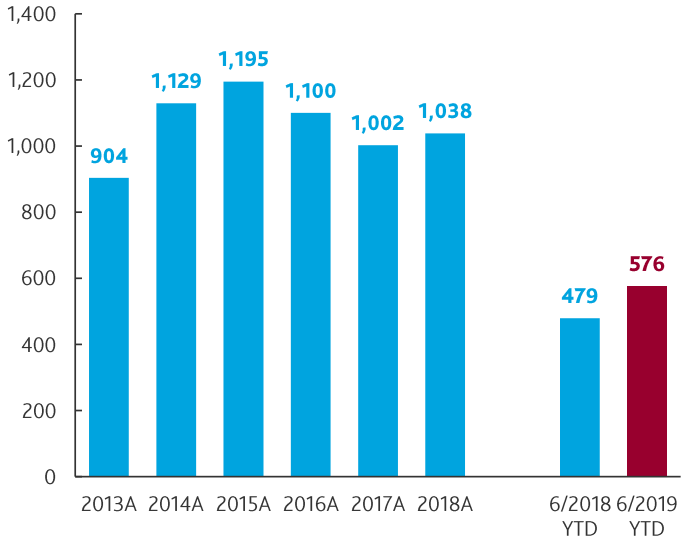
Read details ▶

STATISTICALLY SPEAKING

Volumes

Deal volume in the EC&M sector expanded significantly in the U.S. during the first half of 2019, up 20 percent over the first half of 2018. In total, 576 control sale transactions were reported in the sector during the period (see Figure I for details).

FIGURE I
Transaction Volumes — U.S. EC&M
2013A – June 2019 YTD



Source: BDO Capital Research and S&P CapitalIQ

The surge was really a Q1 phenomenon – with 324 transactions reported, Q1 2019 was up 26 percent over the year-earlier period. It was indeed an exceptional time, only surpassed in the post-recession era by Q4 2012. Q4 2012 was when dealmakers, faced with a threatened increase in the capital gains rate beginning the following quarter, worked overtime to close transactions by quarter-end. This caused a short-lived blip in the historical data. Q2 2019 activity returned to normal and on par with Q2 2018.

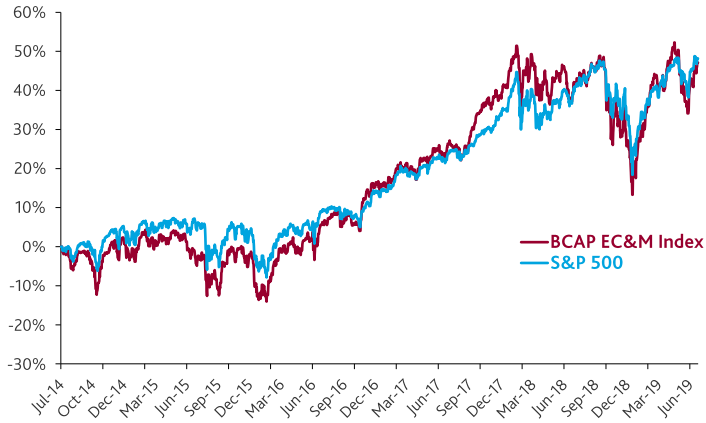
All industries and sectors considered, aggregate deal volume in the U.S. during the first half of 2019 was flat compared to the same period a year ago. Consequently, the EC&M sector has been a bright spot in the M&A landscape. While dealmakers are rightfully concerned about the aging of the current economic upcycle (currently at 121 months) as well as uncertainties about global trade and the general slowing of overseas economies, they have been more upbeat about EC&M than other sectors. It shows in the data with EC&M deals currently representing approximately 20 percent of all U.S. deal volume, a steep rise from 16 percent a year earlier.

Along with foreign strategic buyers looking to own more in the U.S. (no doubt in part to avoid tariff issues), private equity firms are also focused on the EC&M sector. Private equity during the first half of 2019 was involved in 40 percent of sector deal volume. This concentration has been gradually increasing since 2012 when PE was involved in 31 percent of the sector's closings.

Valuations

While modestly more volatile, publicly-traded securities in the EC&M sector have generally mirrored the performance of the broader market during the post-recession period (see Figure II). Our index of more than 700 sector stocks is up 47 percent in the last five years, and up more than 21 percent during the first half of 2019, following a difficult period for the markets in late 2018. This performance is on par with the S&P 500, which includes and benefits from numerous high flyers such as top online retailers and social media companies.

FIGURE II
Public Company Index — U.S. EC&M
July 3, 2014 – June 30, 2019



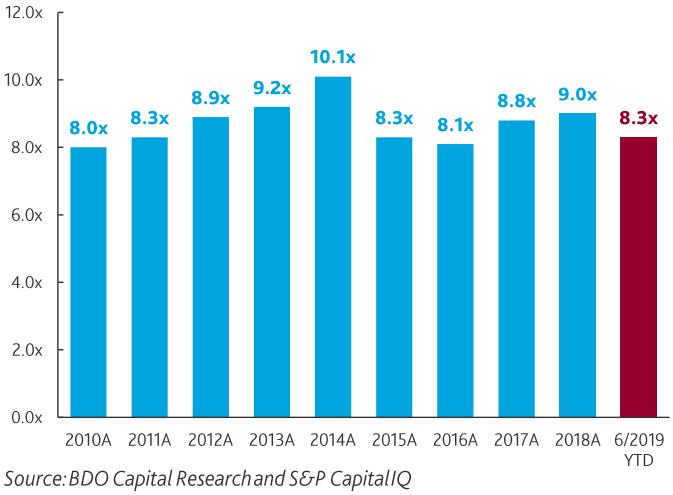
Source: BDO Capital Research and S&P CapitalIQ

Valuation multiples for middle market EC&M transactions peaked in 2014 at an average of 10.1x EBITDA (see Figure III), when prices were driven up by an abundance of strategic and financial buyer interest. Multiples have since moderated but still remain high. This trend has been due in part to a broader mix of companies, including certain less attractive assets, being acquired. The average EBITDA multiple for an EC&M control sale transaction during the first half of 2019 registered approximately 8.3x. We expect to see continuing pressure on multiples given global economic considerations.

That said, business executives and dealmakers have developed a stomach for economic risk. Currently armed with substantial capital, we see both strategic and financial buyers ready to invest and to pay attractive multiples in the process. PE firms generally have enough flexibility in terms of hold period to weather an

economic storm and strategics, who invest for the long haul, are often driven more by strategic objectives than economic ebbs and flows.

FIGURE III
Average EBITDA Multiples — U.S. EC&M Transaction EV of $500M and Under 2010A – 6/2019 YTD



Source: BDO Capital Research and S&P CapitalIQ

ECONOMIC INDICATORS

The U.S. economy remains positive but has been decelerating. Consequently, business executives and dealmakers have cause for caution. However, experts indicated that the likelihood of a recession is remote, save for an unpredicted external event (e.g., war, protracted trade conflict, natural disaster, etc.). The following indicators provide an overview of the economic landscape in which EC&M players operate:

U.S. Gross Domestic Product (GDP)

Annualized GDP grew by 3.1 percent (third estimate) during Q1 2019, up from 2.9 percent during 2018 (according to the U.S. Bureau of Economic Analysis). Contributing to growth were gains in net exports, real gross domestic income, personal consumption, non-residential fixed investment, and state and local government spending.

The Wall Street Journal's survey of more than 60 economists currently predicts a deceleration in GDP growth to between 1.7 and 2.0 percent during the remaining quarters of 2019. This expectation is weighing on the Federal Reserve which is currently signaling a federal funds rate cut may soon happen, especially while inflation remains weak.

It should be noted that the U.S. remains the economic high ground. Most other developed countries had annualized GDP growth percentages of 0.5 percent or less during Q1. This is particularly concerning given the global nature of most middle market companies these days. On the positive side, foreign investors have been increasingly focused on U.S.-based investing in search of better risk/return potential.

Jobs and Wages

Total nonfarm payroll employment increased by 224,000 in June 2019 and the unemployment rate was 3.7 percent according to the U.S. Bureau of Labor Statistics. This news was welcomed after relatively small jobs growth of 75,000 in May. U.S. manufacturers were responsible for 17,000 of the jobs added in June.

The U.S. Bureau of Labor Statistics also reported that wages have risen by 3.1 percent in the last year, a sign of economic stability. Although this is good news, it is important to note that the long-term outlook for EC&M sector jobs is less positive than other sectors. The gradual incorporation of the latest production technologies, while good for competitiveness and the bottom line, is likely to result in labor becoming a smaller component of a manufacturer's cost structure in due time.

ISM Index and Other Surveys

The Purchasing Managers' Index (PMI) produced by the Institute for Supply Management continues to indicate growth in U.S. manufacturing in its June 2019 reading. The June PMI registered 51.7, down from 52.1 in May. Although a reading of 50 or more indicates expansion, it is concerning that the index has generally trended downward in the past year. Respondents in the June PMI expressed concern about U.S.-China trade turbulence, potential Mexico trade actions, and the global economy.

The Small Business Optimism Index, produced by the National Federation of Independent Businesses, fell to 103.3 in June 2019 from 105 in May. Despite the decline, the current reading remains positive and above the historical 44-year average of 98.3.

IN SUMMARY

The EC&M sector is an attractive place to invest. As such, deal volume was up 20 percent during the first half of 2019. PE investing has clearly aided this rise. Valuation multiples, on the other hand, have declined modestly in 2019, with the average EBITDA multiple now at 8.3x (down from 9.0x in 2018). This trend is due in part to the asset mix for sale and a less optimistic and somewhat unclear economic outlook.

The U.S. economy remains strong but is softening. We do not, however, see this trend discouraging sector M&A investment in the near and medium-term.

RECENT SECTOR TRANSACTION

BDO Capital Advisors, LLC, is pleased to announce the sale of Avista Technologies, Inc. and Avista Technologies (UK) Ltd. (collectively Avista or the Company) to Kurita Water Industries, Ltd. (TSE:6370) (Kurita). BDO Capital served as exclusive financial advisor to Avista, working closely with its shareholders and management team throughout the sale process.

Avista, a formulator and global supplier of reverse osmosis (RO) specialty chemicals and provider of technical support for membrane-based water treatment systems, is a trusted expert in membrane system chemistry and global process support, including RO, microfiltration/ultrafiltration (MF/UF), and multimedia filtration (MMF). Avista aims to enhance the life, performance, reliability, and recovery rate of membrane systems. Kurita, a publically-traded company, is a leading supplier of water treatment solutions headquartered in Tokyo, Japan. Kurita has been actively expanding its activities globally by establishing strategic platforms in four key regions of the world – Japan, Asia, Europe, and the Americas. The acquisition of Avista, with its best-in-class chemistries, technical capabilities, and customer base, is another step in that initiative.

This transaction highlights BDO Capital's continued success advising entrepreneur-led companies. In addition, the deal enhances our specialty chemical and water treatment solutions and services credentials and demonstrates our ability to manage complex, multi-national M&A processes in the EC&M sector. Dan Shea, Managing Director, led the engagement for BDO Capital with support from Eric Higgins, Vice President.

About BDO Capital Advisors

BDO Capital Advisors, LLC, a wholly-owned affiliate of BDO USA, is a leading middle market investment bank that focuses on sell-side advisory, acquisition advisory, capital raising, and board advisory services with offices located throughout the United States. The firm has deep industry knowledge, extensive cross-border transaction experience and superior execution capabilities. The firm has broad industry expertise and contacts having closed transactions within the Manufacturing & Distribution, Consumer, Food & Retail, Healthcare & Life Sciences, Business Services, Energy & Natural Resources, and Technology, Media & Telecom sectors. Our seasoned investment bankers have collectively advised on hundreds of transactions for a variety of clients including family-owned businesses, entrepreneur-led companies, public corporations, and leading private equity firms. Our professionals also draw upon the full depth and breadth of BDO USA's national resources which include 60+ offices and more than 5,000 professionals located throughout the United States.

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