Oaklins

Roller-coaster year for IAS includes largest ever acquisition

SPOT ON I INTEGRATED ASSEMBLY SOLUTIONS I NOVEMBER 2019

"In a weakening economy investors brutally differentiate. Whereas ICE-related IAS businesses are often shelf warmers, the tremendous demand for players with exposure to fast-growing, non-automotive-related customer industries leads to record valuations in privately negotiated transactions – regardless of stock market fluctuations."

MARTIN STEIDLE
OAKLINS' INTEGRATED ASSEMBLY SOLUTIONS SPECIALIST

MARKET TRENDS

Since the publication of our IAS report "IAS moves from side stage to hotspot for investors" in March 2019, a number of the report's predictions have come true with M&A activity in the IAS segment continuing to accelerate. In particular, the demand from private equity for IAS targets remains very high, as confirmed in our discussions with relevant market players.

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Market trends

The ongoing trend for the formation of larger entities also continues – an example of this is Quadriga Capital's buy-and-build strategy.

The two IAS players Vescon and Schiller were brought together under a single corporate umbrella and presented as the new SCIO Group in July. Since the merger, two further entities have been added that complement the group's existing engineering and software expertise.

By contrast, the automotive sector has unfortunately been experiencing a downward trend that has accelerated since Q2. The need to make savings is reflected in the increasingly publicized savings programs and investment freezes currently being implemented by automotive groups and suppliers. As the largest IAS user industry, this trend has a direct impact on the IAS segment, particularly affecting those players with a high revenue share working in the combustion engine sector.

One notable event is the ongoing realignment of Thyssenkrupp. On 8 August, the group announced a review of its System Engineering division, which includes Thyssenkrupp's IAS activities. Thyssenkrupp System Engineering ranked seventh in our top 15 IAS ranking, making it one of the world's biggest IAS players. Should the review of strategic options the company announced actually be initiated, it will be interesting to observe whether potential investors in the current market environment take the rare opportunity to acquire a platform in the IAS segment, despite the challenges posed by its strong focus on the automotive sector and high share of ICE-related technology.

In September 2018, MAX Automation SE, Germany's second-largest provider of IAS solutions, announced restructuring measures to divest itself of its interests in the IWM Group, Elwema, and its majority holding in MAX Automation (Asia Pacific). While the announcement that IWM Bodensee and Porta Westfalica were to be liquidated came as a surprise, it also clearly indicates the current reluctance of investors to put money into assets with an automotive focus. Following the sale of the company's minority shareholding in Essert GmbH, the joint venture it entered into with a Chinese partner in 2018 will also be reversed. MAX Automation is currently enduring a difficult year with a lot of upheaval, and is pushing ahead with its goal of reducing automotive dependency. We are excited to see what sort of solution is found for Elwema.

In addition to the adverse global economic headwind, tensions between the USA and China continue to persist due to their trade dispute. Accordingly, M&A activities between these two nations have almost come to a standstill, leading to an increased sense of uncertainty that is having a negative impact on companies' willingness to invest.

A new industry report was published by the International Federation of Robotics (IFR) in mid-September. As the fields of robotics and IAS are interlinked, the developments it lays out also provide a good indicator for the IAS and automation sectors. It places Germany third in terms of robot density, ahead of Japan and behind only Singapore and Korea. If countries are considered on the basis of their total number of robot installations, however, China is still the leader and by quite some way. With a market share of 36%, each year it installs more new robots than Europe and the USA combined. Overall, the total market for robot installations grew by around 6% in 2018 and now has a total volume of around US$16.5 billion. No further growth is expected for 2019 for the time being, while from 2020 to 2022, double-digit annual growth of between 10 and 12% is expected.

Players and M&A activity

Our analysis earlier in the year also addressed the development of relevant M&A transactions in the IAS segment. The peak of 2017 was surpassed in 2018 with 17 completed transactions.

IS 2019 ON TRACK TO BE ANOTHER RECORD YEAR FOR M&A ACTIVITY IN THE IAS SEGMENT?

To answer this question, we analyzed the transactions from 2019 up to and including September. 20 relevant IAS transactions have been identified to date. Therefore, 2019 already marks a new record for M&A activity in the IAS segment. We expect the trend to continue until the end of the year.

A number of known companies made further acquisitions during the period under review. The Chinese company ESTUN Automation expanded its know-how in the field of automated welding technology by acquiring Carl Cloos Schweißtechnik GmbH at the end of August, for example. Prior to this, the acquired Cloos Group itself acquired a majority stake in MPA Technology GmbH back in May.

In addition to transactions in the classic IAS segment, an increasing number of transactions with targets in non-traditional IAS customer industries were also identified. These include Abbott Laboratories' acquisition of GLP Systems GmbH, a provider of laboratory automation, further strengthening Abbott's own laboratory automation capabilities. Another example is the acquisition of Brimato Catering Automation Technology GmbH by BLANCO Professional GmbH & Co KG, a manufacturer of capital goods for industrial kitchens and the catering industry. With this acquisition, BLANCO is expanding its service portfolio to include automation solutions for large-scale kitchens, dishwashing kitchens and portioning kitchens. These acquisitions allow the buyers to expand their range of services in existing industries.

We also observed players from outside the industry looking to enter the IAS segment. The acquisition of Hoyer Montagetechnik GmbH by the packaging machine specialist FOCKE is one example of this. By acquiring a specialist in automated assembly and manufacturing systems, FOCKE enters a new market with an IAS company that supplies traditional customer industries such as automotive.

Valuation update

HAS THE WEAKENING ECONOMIC SITUATION AFFECTED THE VALUATION LEVEL IN THE IAS SEGMENT?

To find out, we carried out a quantitative analysis of enterprise valuations over the course of the past year. Our analysis continues to be based on comparisons of five listed IAS players from Europe and North America. The reference point was defined as the beginning of 2019 and the development scenario visualized up to 30 September 2019.

We first formed an index from the median of the five company valuations. At the beginning of the year, the two multiples (EV/EBIT and EV/EBITDA) of the index were 10.6x/8.1x in relation to the respective company value. A visualization of the multiples over the course of the year, made on the basis of 2019E earnings figures, shows an initial significant increase until the middle of the year. This development can be primarily attributed to the sharp rise in the overall market, after a broad correction towards the end of 2018 caused prices to fall to a several-month low (with the Dow Jones Industrial Average reaching its lowest value on 26 December 2018). In May, company valuations in the IAS segment reached highs of 16.4x/12.3x. This was followed by a sustained downward trend. At the end of September, valuations were slightly lower than at the beginning of the year, despite growing volatility.

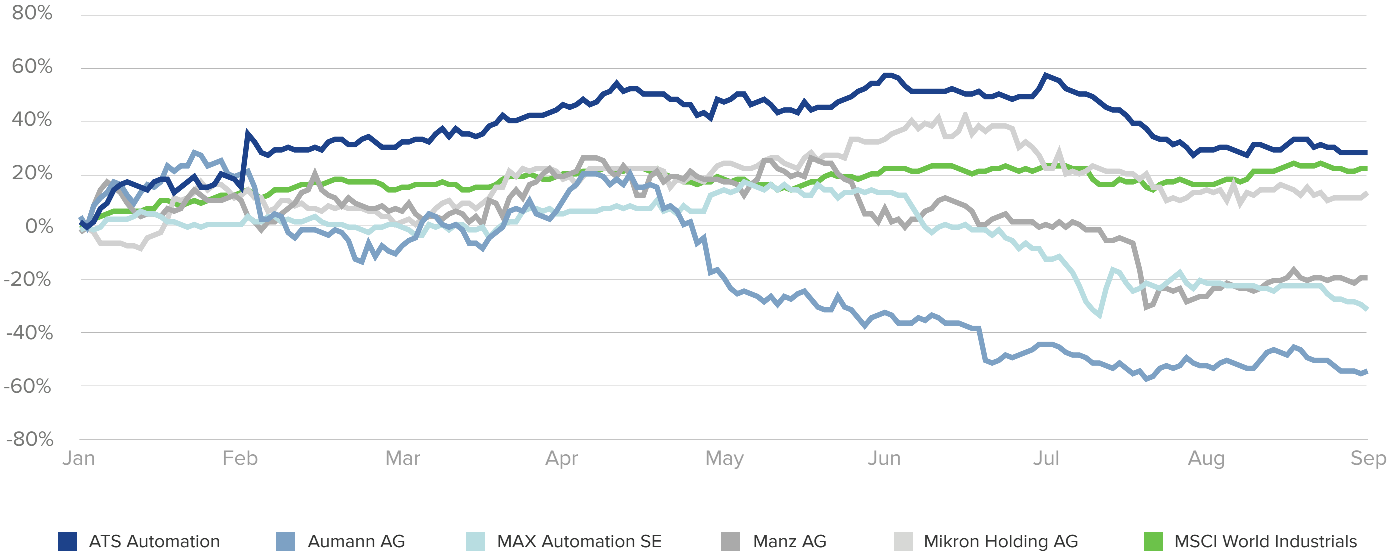
Valuation within the IAS peer group, 2019E

Source: S&P Capital IQ

A further perspective is offered by comparing the stock prices of the five individual companies, using the performance of the MSCI World Industrials Index as a benchmark.

The graph below shows that only the Canadian firm ATS Automation managed to outperform the index during the period under review. As of 30 September 2019, its share price had risen by approximately 28%.

Share prices IAS peer group vs. MSCI World Industrials



Source: S&P Capital IQ

The Swiss company Mikron Holding AG is the only other of these companies to achieve a positive annual performance, recording an increase of 13% on the reporting date.

The three German companies (Aumann AG, Manz AG and MAX Automation SE) in the IAS peer group demonstrated below-average performance in the period under review, with Aumann AG losing more than 50% of its market value since the beginning of the year. The negative performance of these three companies has a correspondingly strong impact on the index of the comparison group.

In conclusion, it can be determined that valuations in the IAS segment were very volatile in the period under review, reflecting the economic slowdown experienced since Q2. The cost-saving programs already initiated by the automotive industry are having a particular impact on those suppliers who are highly dependent on classic combustion engines. The evolution of ATS and Mikron hints that companies with a relatively low automotive exposure (less than one third of total revenues) are valued at least as high as the benchmark and even outperform. This illustrates why many IAS suppliers are trying to further diversify their customer industries and, in particular, reduce their dependencies on the automotive industry.

We observe from ongoing transactions within the IAS segment that valuations of companies with strong financial performance are still very high and have not decreased at all since the beginning of the year.

Spotlight

HITACHI ACQUIRES JR AUTOMATION

It's with great interest that the industry has observed the largest pure play acquisition ever made in the IAS segment, with the Japanese conglomerate Hitachi acquiring the American company JR Automation Technologies for US$1.425 billion. Here we take a closer look at this transaction.

AN OVERVIEW OF THE PARTIES INVOLVED

The American company JR Automation Technologies, based in Holland, Michigan, specializes in the integration of robotic systems for the automation of manufacturing and testing applications. JR serves a diverse mix of client industries, and in 2015 it was acquired as a platform investment by private equity firm Crestview Partners. The company generated sales of approximately US$170 million that year. With this acquisition, Crestview pursued a stringent buy-and-build strategy that intensified in the following years with its acquisitions of further American automation specialists, such as Esys Automation, Setpoint Systems and Doerfer Corporation. By 2018, sales had risen to over US$600 million and an international footprint of 23 locations had been established.

Hitachi is a diversified multinational conglomerate listed on the Tokyo Stock Exchange. In 2018, it generated sales of nearly US$85 billion with an EBITDA margin of approximately 10%. In addition to industry, the company also covers the mobility, smart life, energy and IT segments. The group has set itself the strategic goal of achieving a leading international role in the area of cyber-physical systems. From 2015 onwards, considerable financial resources have been earmarked for investment in companies in the industrial and IT sectors (approximately US$25 billion by 2025).

WHAT IS HITACHI'S GOAL IN ACQUIRING JR AUTOMATION?

Hitachi is increasingly positioning itself as a system partner for the transition from machine manufacturing to robotic automation. By combining the manufacturing process with the data it generates, Hitachi aims to enable a holistic management process that can then be implemented using its in-house industrial IoT and operations intelligence platform, Lumada – so-called 4M data (Method, Material, Machine, huMan) form the basis for this. With Lumada, Hitachi is competing with other IoT platform vendors such as Siemens (MindSphere), IBM (Watson IoT), Microsoft (Azure IoT Edge) and General Electric (Predix).

Hitachi is accelerating the development and expansion of its own competencies as an independent system integrator for the generation of end-to-end data. The need for competence and data is also the reason behind its acquisition of JR Automation.

In addition to Japan, Hitachi's strategy identified the North American market as a target. It first entered the market in July 2017 with the acquisition of Sullair (approximately US$1.25 billion), a leading American supplier of air compressors. This gives Hitachi access to a very broad customer base and distribution network, and the ability to market digital solutions through these two channels. The next step was the acquisition in March 2019 of the Japanese company KEC, a leading system integrator of robots for production-line automation with a focus on the automotive industry. The company's acquisition of JR Automation, announced in April, represented its direct entry into the American IAS market. This move gives Hitachi access to a broad base of installed IAS systems.

Apart from the purchase price of the transaction, no detailed information on the valuation was published. It can be assumed that a significant double-digit EBITDA multiplier was paid.

JR AUTOMATION

has been acquired by

HITACHI
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IAS is one of our areas of focus. Our combination of extensive industry knowledge and global capabilities has made Oaklins one of the most experienced M&A advisers in the IAS segment, with a network of relationships with market players across the world. This opens up the best possible opportunities for merger, acquisition and divestment for our customers.

If you are looking to make mergers, acquisitions or divestments of companies or business entities as part of your strategy, we would be very pleased to exchange ideas with you.

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