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Advanced Manufacturing highlights

Global Capital Confidence Barometer

Kris Ringland
EY Global Advanced Manufacturing & Mobility Leader
Strategy and Transactions

kristin.ringland@parthenon.ey.com
+46 8 52059278

Peter Aman
EY Americas Advanced Manufacturing & Mobility Leader
Strategy and Transactions

peter.aman@parthenon.ey.com
+1 404 541 7253

A note from Kris Ringland and Peter Aman

How global manufacturers are thinking about M&A

As manufacturers globally absorb the impact of the COVID-19 pandemic and address urgent, strategic issues, some are stepping back from M&A, investing internally or considering alliances.

Faced with the debilitating impact of the pandemic on global economies, competition for assets and a mounting focus on filling commercial and operational gaps in their business models, 78% of manufacturing executives do not expect profits to recover to pre-pandemic levels until 2022 or later, according to the 23rd EY *Global Capital Confidence Barometer* (CCB). While sales growth and margins have improved since the CCB survey closed in February, manufacturers remain concerned about supply chain challenges and other issues.

The CCB shows that fewer than half of manufacturers (48%) surveyed expect to actively pursue mergers and acquisitions; while that is a decline of 8 points from our last survey, it is in line with other sectors (49%) this year.

Mounting competition for scarce assets may be hindering deal sentiment as private investors drive up prices — especially for businesses focused on automation, analytics and advanced additive tools used in manufacturing. Half (52%) of the survey's manufacturing respondents say they failed to complete or canceled a planned acquisition in the past 12 months, and the top reason is disagreement on price/valuation (25%).

This unprecedented combination of imminent challenges and risks is having a dramatic impact on how leaders think about M&A, the workforce and their international footprint.

78%

of manufacturing executives surveyed do not expect profits to recover to pre-pandemic levels until 2022 or later.

Investing to transform in tough times

However, despite partially stepping back from traditional M&A, some manufacturers are investing internally or considering alliances to build their digital capabilities.

Survey respondents in manufacturing rank investing in digitization of customer journeys and business processes as a top strategic action in progress. Among those who identify ecosystem changes in their businesses, the majority (82%) say they would partner with competition to create new ecosystem solutions.

For manufacturing executives considering M&A, when asked how the pandemic has impacted their strategy and outlook, 21% say they focus more on a target's business resilience, the single largest result. They also cite a focus on the target's digital strategy and technology alignment (18%).

55%

of manufacturing executives expect primary M&A activity to be bolt-on acquisitions.

Of those manufacturers planning M&A, the largest grouping (55%) expect primary M&A activity to be bolt-on acquisitions in the same sector designed to increase market share. Only 22% plan a transformative deal, which could involve a new business model and customer base, or major geographic expansion. Another 18% plan acquisitions focused on operational improvements including production efficiencies or distribution chain improvements, and a mere 5% are looking to acquire in an adjacent sector.

The focus on bolt-on acquisitions may point to the formidable deal competition from private equity funds' dry powder that built up during the pandemic. Manufacturing executives indicated they expect increasing competition from private capital (60%) relative to corporate buyers (40%), whose resources may be limited by the pandemic, precluding payment of premium prices for digital or tech assets.

International strategy and geopolitics

Government policies enhancing domestic production and national competitiveness play a key role in manufacturers' decisions about global development and M&A.

Among manufacturers, 65% say such policies affect their international footprint, 63% cited the impact on entering an international market, 59% pointed to the impact on domestic M&A and 56% noted the impact on cross-border M&A.

When it comes to acquisitions, investments and geography, manufacturers pointed to regulation, tariffs, trade changes and a secure supply chain as strategic drivers in their decisions. For the near term, the survey shows manufacturers' top domestic and cross-border M&A destination is the United States, reflecting some manufacturers' desire to be closer to customers, followed by India. Looking out over the next three years, manufacturers are eyeing parts of Asia and Europe for growth and opportunities.

Top five investment destinations (includes both domestic and cross-border M&A)

Conclusion

For some manufacturers, the drive to pursue M&A deals may be tempered by price premiums and continuing supply chain challenges, as well as concerns about national policies and the location of operations. For others, a return to profitability sooner than expected may boost M&A sentiment.

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