

Advanced Manufacturing Global Capital Confidence Barometer



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A note from David Gale, EY Global Advanced Manufacturing Transactions Leader

Advanced manufacturing companies focus on cash and supply chain; M&A mostly on hold

Advanced manufacturing companies have been among the hardest hit by the COVID-19 crisis. The virus has disrupted global supply chains, reduced capacity and demand, and compelled workers in many areas to remain at home, shutting down factories.

The impact is recognized by respondents in this edition of the EY *Global Capital Confidence Barometer* (CCB): When respondents from all industries were asked which sectors would be affected by the virus, advanced manufacturing was the second-most frequent sector picked. Only automotive and transportation were picked more frequently, and even those are key end markets for advanced manufacturers.

Now: focusing on liquidity

We see the impact as we talk with our clients: cash is king right now. Only essential spending is happening, and other than deals that might have already been in flight or were near closing, M&A in general is on hold. In some cases, even those close to completion are being tabled. We are, however, starting to see an increase in distressed M&A in the current and near-term environment.

The virus also affected the CCB itself: the initial survey for the report was in the field for several weeks as the impact of the virus went from regional to global and stock markets were hitting record highs. Our focus here is on results after 19 February 2020. Even so, there is still uncertainty as to the lasting impact on the global economy and the advanced manufacturing sector.

Governments, advised by medical experts, will decide when factories will open. Their combined efforts will also help determine what shape the economic recovery will take. More than half of advanced manufacturing executives (53%) expect a “U-shaped” recovery, with slower economic activity extending into 2021, in line with results from all industries.

The post-recovery period will almost certainly be a “new normal,” which will likely include higher unemployment, a smaller economy, changes to the supply chain, industry consolidation and a smaller manufacturing footprint. There will also be more of a focus on technology and a change in the way that people work.

Next: supply chain changes, falling valuations

Global supply chains were an area of focus for companies even before the virus hit, as tariffs and trade conflicts highlighted the potential vulnerabilities of geographic concentration of key manufacturers and suppliers. The crisis is bringing supply chains more to the fore, with 52% of advanced manufacturing companies saying the virus has already caused them to take steps to change their supply chains and 45% saying they are re-evaluating the supply chain.

Some suppliers are attempting to diversify their supplier base, including geographically. The COVID-19 crisis could also lead to more vertical integration, with healthier companies acquiring weaker ones. But that integration should focus on strategic areas for the company. The manufacturing industry has seen the market benefits of deconglomeration, and this is not likely to change.

Meanwhile, almost half (47%) of advanced manufacturing executives expect valuations to fall in the next 12 months, compared with 39% for respondents of all sectors. Companies will monitor their M&A pipelines; those with stronger balance sheets might consider acquisitions that fit into their already defined strategies. After years of divesting and honing their strategic focus, manufacturing companies are not likely to deviate from their strategy just because an unrelated asset is available at a fire sale price.

Beyond: focus on business resilience

It could be a year or more before the M&A market in the industry finds a new normal (at least temporarily, given the cyclical nature of the industry). Even then, buyers may be considering new factors when they look at targets. For example, 32% of advanced manufacturing executives said they will focus more on a target's business resilience.

Other initiatives, such as the shop floor of the future, digital transformation and the use of artificial intelligence, are being re-examined as manufacturers balance short-term liquidity needs against long-term investments. Respondents were more likely to say that they were re-evaluating efforts in these areas rather than taking steps to change.

These strategic initiatives will still be essential for successful manufacturing companies in the future and successful companies are already strategically looking at the present, near-medium term and post-crisis new normal. But it will likely take some time to get back to focusing on these transformations.

53%

expect a "U-shaped" recovery with slower economic activity extending into 2021.

52%

are taking steps to change their global supply chain in response to coronavirus.

47%

see valuations coming down (compared with 39% of respondents across all sectors).

32%

will focus more on a target's business resilience.

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