

# BMO Middle Market M&A update

## The Current State of Add-On Acquisitions

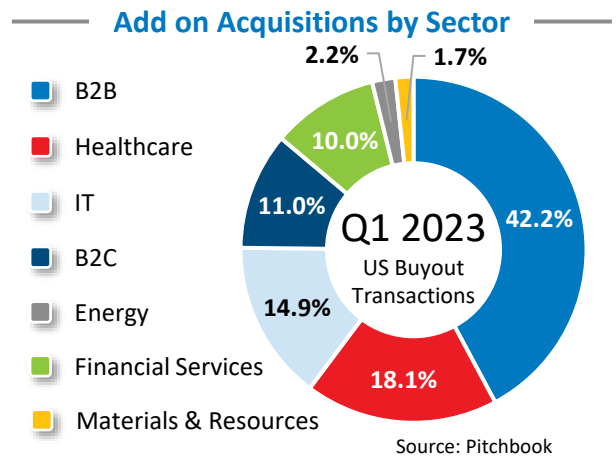
In the current economic environment, which continues to be characterized by rising inflation and interest rates, add-on acquisitions have become an increasingly prevalent means for private equity investors to deploy their near-record levels of dry powder, in part driven by the uncertain financial environment.

Add on acquisitions made up ~80% of all US buyout transactions in the first quarter of 2023. This is compared to the pre-COVID period in 2019, where add-ons made up ~68% of US Buyouts.

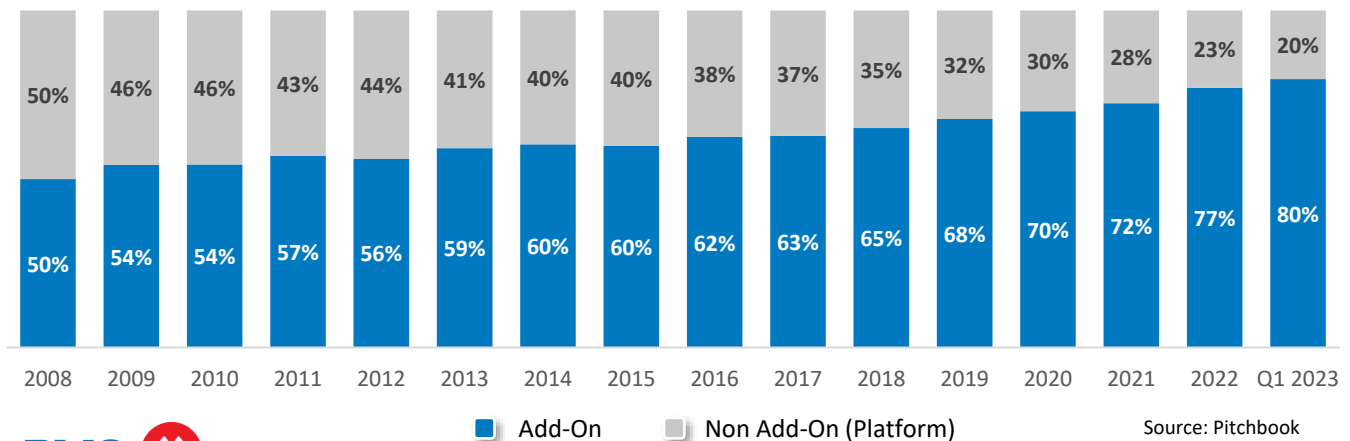
The relative size of most add-on acquisitions in relation to a full platform acquisition is one of the major reasons they have become so attractive to private equity investors. Smaller acquisitions like add-ons are more easily financed, which is a key consideration in the currently constrained leverage markets. These acquisitions also offer incremental EBITDA additions which can help to offset the increased cost of debt. They also typically include an existing labor force, which has otherwise become a key element inhibiting growth for investors.

Another important attribute of add-on acquisitions in the current environment is that they allow investors to continue with an already proven thesis, rather than making a new and larger, full platform investment. Platform investments are generally expensive and force investors to bear significant risk. Add-ons allow investors to augment an already successful platform where they have operational expertise and can likely realize synergies that ultimately lead to multiple expansion upon exit.

In the immediate term, investors' interest in add-on acquisitions will likely only increase given their lower risk nature and return potential. While Financial Sponsors' appetites for larger, platform creating transactions will likely heighten as interest rates begin to normalize, it is unlikely that demand for add-on acquisitions will soften given the returns that can be achieved through multiple arbitrage.



## Add-On Transactions as a Share of US Private Equity Buyouts



# Reshoring and Nearshoring as Drivers of US M&A

Reshoring and nearshoring involves transitioning business operations, primarily manufacturing, from overseas low-cost countries (“LCCs”) back to the United States or its North American neighbors. In 2022, US imports of goods from 14 Asian LCCs totaled ~14.1% of US domestic gross manufacturing output, which represents a decrease from the previous year when imports from these countries totaled ~14.5%. This year-over-year decrease represents the first time that US manufacturing growth has outstripped LCC import growth since 2019.

The trends of reshoring and nearshoring are driven by several factors including the desire for supply chain diversification, quality control and concerns over security of intellectual property, as well as government incentives for domestic manufacturing.

## Quality Control & IP Security

Many LCCs do not have the same quality control standards and intellectual property protections that the US has. Lower QC standards stem from less direct oversight and, less frequently, language barriers which can lead to disjointed process controls. Less stringent IP regulations and potential uneven enforcement, leading to IP infringement can compromise a company’s competitive advantage and have a negative impact on bottom line, illustrating the tangible value of a domestically based supply chain.

## Supply Chain Certainty

Supply chain disruptions related to the COVID-19 pandemic impacted the ability of many companies, who traditionally utilized overseas suppliers, to meet the demand of their customers. This inability to meet demand illustrates the tangible value a reliable, resilient supply chain can create.

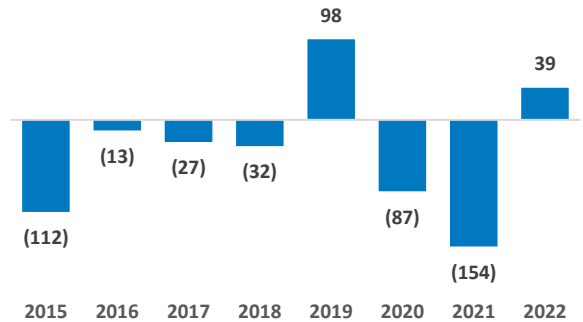
## Government Policy

The US Federal Government has put into action several policies in recent years, which incentivize companies to base operations domestically including the Inflation Reduction Act (“IRA”) which specifically took aim at reshoring EV battery production as well as the CHIPS<sup>1</sup> act which is intended to drive investment in domestic semiconductor manufacturing.

## Impact on M&A

While the relative lower cost of overseas manufacturing will likely continue to support transactions involving companies with international supply chains, as economic uncertainty rises, investors may begin to prioritize transacting with companies that have North American based capabilities to mitigate risk while still deploying capital and generating returns. CEO’s have begun to consider more reshoring opportunities, but still early to determine if 2022 or 2023 mark a long-term shift in trend.

## Kearney Reshoring Index<sup>2</sup>



## CEO Reshoring Survey<sup>2</sup>

Have decided to reshore some of their manufacturing operations to the US in the following 3 years



1. “Creating Helpful Incentives to Produce Semiconductors” (CHIPS)
2. “America Is Ready for Reshoring. Are you?” Tenth Anniversary of Kearney’s Annual Reshoring Index

## Let's connect

Whether you're expanding through acquisition or are ready to transition the business, our middle-market M&A experts are ready to help you take your company to the next phase.

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