



MANUFACTURING & DISTRIBUTION M&A QUARTERLY

Q2 2022

MANUFACTURING & DISTRIBUTION M&A QUARTERLY: Q2 2022

Helana Robbins Huddleston, Richard Chase, and Michael Pezzullo

Inflation, rising interest rates, stock market fluctuations, and supply chain disruptions are some of the driving factors impacting M&A deal flow for the Manufacturing and Distribution space. The annual inflation rate for the U.S. rose to 9.1% for the 12 months ending June 2022. That was the largest annual increase since November 1981. Inflation, along with rising fuel costs, continues to threaten consumer spending power. As the debt rates continue to climb, there is a lingering question to whether the country is entering a recessionary period, driving investors to cautiously assess the market situation and any potential acquisition or investment right now.

The capital invested in the Manufacturing and Distribution sector during Q2 totaled \$30.13 billion across 655 deals. This is in contrast to Q1 2022, where we saw \$90.05 billion invested in 909 deals. The top deals in Q2 included KPS Capital Partners' \$3.45 billion acquisition of Oldcastle BuildingEnvelope, a manufacturer of architectural hardware, glass and glazing systems, and the sale of specialty materials producer Ferro to Prince for \$2.1 billion.

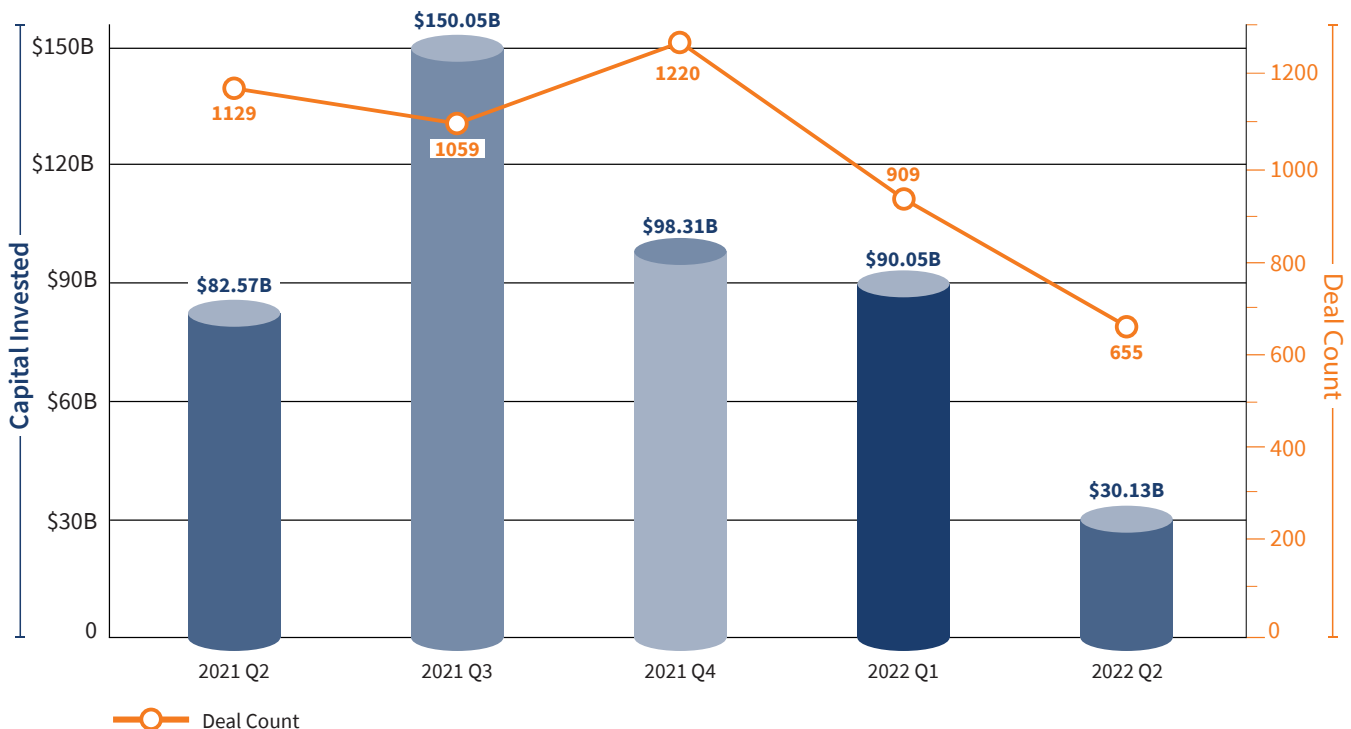
With the significant volume of deals that closed at the end of 2021 – 1,220 deals in Q4 2021 – and seller's taking a break in Q1 2022, we expect more deals to come to market in Q3 2022 which will likely lead to more deal activity in the coming months.

SKIP TO A SECTION:

- Q2 2022 trending numbers
- Market factors impacting the deal space
- What's next?
- Tax issues impacting the M&D sector
- Food manufacturing deals

Q2 2022 TRENDING NUMBERS

All data gathered from PitchBook Data, Inc., as of July 1, 2022





Manufacturing and Distribution M&A activity continued to slow during the second quarter of the year, with total deal volume equaling \$30.13 billion compared to \$82.57 billion during Q2 2021. Deal count also decreased from 1,129 in Q2 2021 to 655 during the most recent quarter.

The top 10 Manufacturing and Distribution deals that closed in Q2 2022 were primarily focused on the B2B sector. This isn't surprising in light of inflation and recessionary concerns, and with the prospect of consumers spending less and saving more.

Although the deals slowed down in general in Q2, some private equity investors remained extremely active including The Carlyle Group, which closed 10 total deals in Q2 2022. Other top investors during the quarter included The Jordan Company (nine deals closed), Audax Group (seven), and Bain Capital (five). The top 10 deals included the acquisitions of Oldcastle BuildingEnvelope, C.H.I. Overhead Doors, Ferro, Varroc Lighting Systems, Quality Synthetic Rubber, First Alert, and Tensar International.

Along with the focus on B2B companies, investors showed an affinity toward the information technology, healthcare, and energy sectors. More specifically, it appears that companies involved with construction, home improvement, and related products are of particular interest to investors and acquiring companies.


Q2 2022 top investors: Most active private equity firms based on number of deals

Private Equity Fund	Deal Count
▶ The Carlyle Group	10
▶ The Jordan Company	9
▶ Audax Group	7
▶ Bain Capital	5
▶ Clearlake Capital Group	5

MARKET FACTORS IMPACTING THE DEAL SPACE

Most of the top challenges that manufacturers and distributors were dealing with during Q1 continued right into Q2, including:

TOP MARKET FACTORS IMPACTING THE DEAL SPACE

 <p>Supply chain disruption</p>	 <p>Lengthy order lead and delivery times</p>	 <p>Persistent labor shortage</p>
 <p>Transportation bottlenecks and capacity crunches</p>	 <p>Impacts of the Russia-Ukraine war</p>	 <p>Higher gas prices</p>



Some of the newer trends impacting companies during the quarter included:

Inflation. Inflation is significantly impacting consumers at levels not experienced in more than 40 years. With the increasing costs of buying and renting homes, weekly groceries, filling up the gas tank, booking travel, and more, rising prices hit U.S. consumers across the board during Q2.

The Fed hikes interest rates by 0.75%. Looking to curb inflation, the Federal Reserve raised interest rates in June. That was the biggest move that the Fed has made in a single meeting since 1994 and further interest rate hikes could come later this year.

Fear over a looming recession. [Economic prognosticators](#) and [Wall Street stock pickers](#) feel that the economy and markets will get worse before they get better. CNBC says 40% of CFOs cite inflation as the top external risk to their businesses.

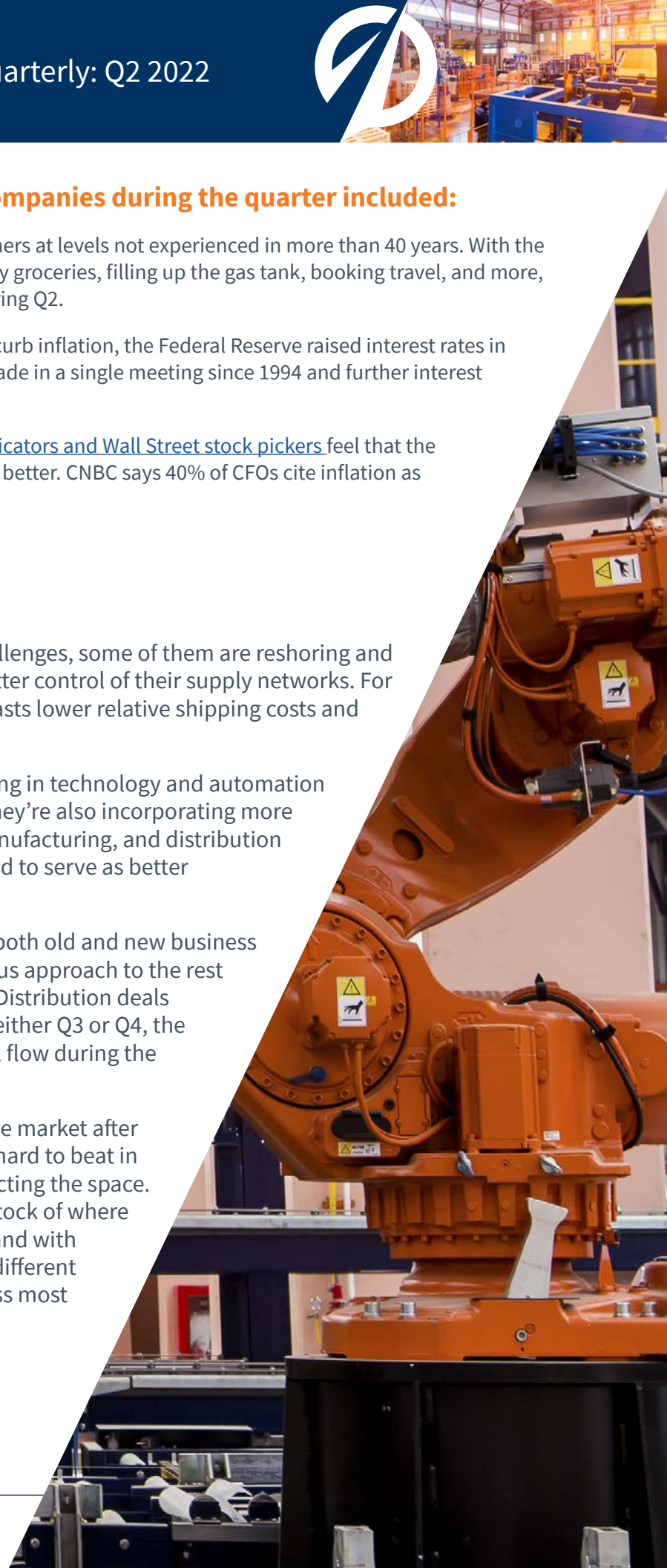
WHAT'S NEXT?

As companies continue to face supply chain challenges, some of them are reshoring and nearshoring their operations in order to gain better control of their supply networks. For example, Mexico is one attractive target that boasts lower relative shipping costs and an available/affordable labor force.

More manufacturers and distributors are investing in technology and automation to help them work smarter, better, and faster. They're also incorporating more sustainability into their design, engineering, manufacturing, and distribution processes in response to customer demands, and to serve as better environmental stewards.

Emerging from a quarter populated by a mix of both old and new business challenges, companies are taking a more cautious approach to the rest of the year. And while some Manufacturing and Distribution deals are already in the works, and will likely close in either Q3 or Q4, the continued uncertainty could further impact deal flow during the upcoming quarter.

This could also be a sign of a “normalizing” in the market after an extremely active year in 2021, which may be hard to beat in light of the many outside factors currently impacting the space. The industry may be slowing down and taking stock of where it is now – more than two years post pandemic and with a potential recession looming – but it's not any different than the surface hesitancy that's being felt across most industries right now.





TAX ISSUES IMPACTING THE MANUFACTURING AND DISTRIBUTION SPACE

With new tax changes this year, U.S. manufacturers are facing some pressures as they work to keep up with these changes. Some of the looming tax concerns impacting the M&D sector right now include:

- 1. Currently at 100%, the bonus depreciation for Section 174 expenses decreases to 80% expensing in 2023.** As companies defer some capital expenditures into 2023, they may get pinched by the loss of tax deductions. The question they're asking themselves now is: Should we trade that 20% deduction for cash we have today versus holding onto it to see what happens with the economy and our businesses tomorrow? We've been working with our manufacturing clients to quantify what the swing in their depreciation deductions would cost them on a tax basis and helping them to make that decision for themselves. This also requires calculating what the runoff of current tax depreciation is and then conducting a scenario analysis.
- 2. The favorable treatment for amortization and depreciation deductions for Section 163(j) limitations is going away.** This means companies may need to defer more of their interest expense deductions because they're not going to get the benefit of depreciation and amortization as favorable adjustments to help them calculate the base for deducting interest expenses. This is a big deal for manufacturing companies, especially those that have gone through a recent transaction and have taken on leverage.
- 3. All NOLs now have to be carried forward.** The Tax Cuts and Jobs Act (TCJA) altered the rules for deducting net operating losses (NOLs) when it limited NOL deductions to 80% of taxable income, disallowed NOL carrybacks, and lifted the 20-year limit on NOL carryovers. Coronavirus Aid, Relief, and Economic Security Act (CARES Act, P.L. 116-136) allowed a brief window where there was an extended

NOL carryback opportunity, but that window of opportunity closed in 2020. Now, any NOLs have to be carried forward and their use is limited to 80% of taxable income. When TCJA eliminated the corporate alternative minimum tax (AMT) there was a collective sigh of relief. However, by creating the limitation on the ability to use NOLs going forward, companies can find themselves in a taxable income position even with large NOL carry forwards.

- 4. Tax implications are driving a bigger focus on deal structure.** There's a lot more emphasis on the type of legal entity that's doing the acquisition – whether it's a C corporation, an S corporation, a partnership, etc. – and whether the acquisition will be structured via an equity or asset deal, namely because everyone is trying to figure out what the future tax rates are going to be. For example, there's currently up to an approximate 20% spread in the tax rates between C corporations and flow-through entities, but that spread could potentially change. Knowing this, the emphasis with deal structuring is on making the transaction as tax efficient as possible for all parties involved, both on a current and prospective basis, and this is becoming increasingly more important as interest rates rise.

With rising labor costs, continued supply chain disruption, and increased inventory costs, many manufacturers may be incurring an NOL but the current tax law no longer allows them to carry back or monetize those losses. This is leaving companies pinched in this environment of unfavorable tax law factors coupled with a potential economic downturn. Some manufacturers are in a position where they're not driving current deductions and are instead creating deferred losses. As a result, some companies may wind up strapped from a cash flow position amid the uncertainty of what may (or may not) be in terms of tax law changes for the rest of the year.



FOOD MANUFACTURING DEALS

Companies that produce in-demand foods continue to remain an evergreen target for private equity investors, venture capitalists, and strategic businesses looking for viable M&A deals. During Q2 2022, Syracuse Sausage was acquired by Standard Meat Company, and the snack food manufacturing facility of Benestar Brands was acquired by Utz Quality Foods, a subsidiary of Utz Brands, for \$38.4 million.

One of the larger food manufacturing deals happened near the end of Q2, when Mondelez International purchased Clif Bar & Co., for \$2.9 billion. The latter makes energy bars with organic ingredients. Being fiercely independent and started in its founder's kitchen, Clif Bar had previously fended off a \$120 million offer from Quaker Oats.

Other food deals that closed during Q2 included Hyfé Foods' \$2 million in pre-seed funding led by The Engine; Motif FoodWorks' \$226 million in Series B venture funding led by Ontario Teachers' Pension Plan and BlackRock; and the \$500,000 in venture

funding that went to AuraPea. The Motif FoodWorks deal is particularly significant in that it signals growing interest on the part of venture capital firms to cut larger checks for a sector that usually sees investments below \$10 million from such firms.

All three companies are using innovative production approaches to create nutritional foods in a sustainable manner. Hyfé Foods developed an advanced biomanufacturing platform that uses fungal fermentation to valorize waste and lower greenhouse gas emissions; Motif FoodWorks makes sustainable alternative proteins and wide-ranging ingredients for innovative food producers; and AuraPea produces plant-based, high-protein products from chickpeas.

Plant-based alternative proteins continue to disrupt the food and beverage space as more companies get in on the trend and more consumers are willing to try these products as meat costs continue to rise due to inflation. Plant-based bacon has been one of the most recent products coming onto shelves this year

Q2 2022 food manufacturing deals

Company Name	Deal Date
▶ Bond Pet Foods	24-Jun-2022
▶ Keyes Coverage	07-Jun-2022
▶ Syracuse Sausage	07-Jun-2022
▶ Fiesta Canning	01-Jun-2022
▶ Hyfé	23-May-2022
▶ Motif FoodWorks	18-May-2022
▶ Benestar Brands	29-Apr-2022
▶ AuraPea	26-Apr-2022
▶ Made by Nacho	18-Apr-2022
▶ Passtur	01-Apr-2022



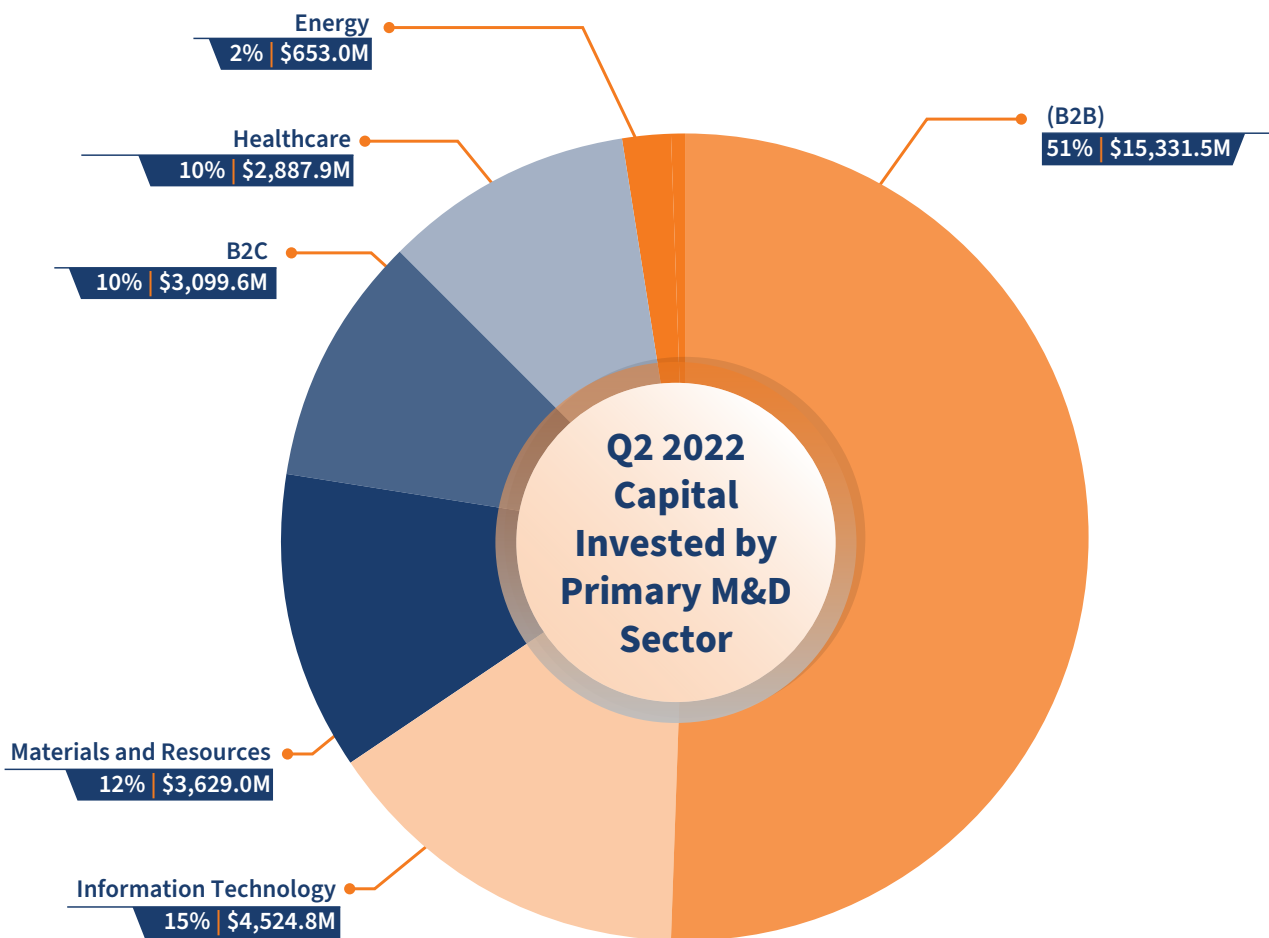
with multiple brands launching plant-based bacon products including Umarm Foods, Hooray Foods, MYForest Foods, and Prime Roots. Another plant-based product seeing more time in the market is fish alternatives with Gathered Foods Corporation’s plant-based salmon burger winning the 2022 Specialty Food Association award for new product in plant-based protein. Good Catch Foods has also been active in the space with its plant-based tuna alternative launched in 2019 and beginning to be stocked at Sprouts Farmers Market in March 2022. Good Catch Foods also offers plant-based crab cakes, fish burgers, and filets.

While venture capitalists continue to invest in new concepts and good-for-you (and the environment) products, we are seeing legacy brands also staying relevant and launching new products and flavors.

For example, [Jelly Belly showcased](#) its new Harry Potter Collection of candies including Harry Potter Butterbeer Chewy Candy and Harry Potter Butterbeer Milk Chocolate Bar at the 2022 Summer Fancy Food Show.

Retailers have re-opened their shelves to new products after a long period of only stocking the status quo. In the coming year, we expect to see many more products and brands launched that are innovative in the use of flavors, ingredients, and production methods with a continued focus on environmental, social, and governance concerns.

Q2 2022 capital invested by primary M&D sector



Contact

Helana Robbins Huddleston, CPA, CIRA, Partner, Transactional Advisory Services
Author, *Manufacturing and Distribution M&A Quarterly*, Q2 2022
312.508.5813 | helana.robbs@cohnreznick.com

Henrietta Fuchs, CPA, Partner, Manufacturing and Distribution Industry – Co-Leader
646.762.3432 | henrietta.fuchs@cohnreznick.com

About CohnReznick

As a leading advisory, assurance, and tax firm, CohnReznick helps forward-thinking organizations achieve their vision by optimizing performance, maximizing value, and managing risk. Clients benefit from the right team with the right capabilities; proven processes customized to their individual needs; and leaders with vital industry knowledge and relationships. Headquartered in New York, NY, with offices nationwide, the firm serves organizations around the world through its global subsidiaries and membership in Nexia International.



© 2022 CohnReznick LLP | This has been prepared for information purposes and general guidance only and does not constitute legal or professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is made as to the accuracy or completeness of the information contained in this publication, and CohnReznick LLP, its partners, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.



CohnReznick is an independent member of Nexia International

