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Plastics M&A looking to bounce back after a virus-battered first half

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Graphic by Amy Steinhauser

First-half deal volume fell by about one-third, market watchers say second half could see more distressed deals.

The COVID-19 pandemic has slowed down a multiyear streak of white-hot activity for plastics M&A.

Plastics and packaging deal volume fell by almost one-third in the first half of 2020, dropping from 169 to 115, according to P&M Corporate Finance of Southfield, Mich.

Major declines were seen in April with only 11 deals and May with only six deals. The market rebounded strongly in June, however, when 25 deals were recorded.

Based on end market, large drops were posted in food and beverage, where deals fell from 37 to 13, and medical, with only 10 deals in the first half of 2020 vs. 19 in the same period in 2019.

By sector, the number of film deals plummeted from 32 to 12, with injection molding deals down from 50 to 29, according to PMCF. Based on product segment, the number of flexible packaging deals tumbled from 29 to eight, with rigid packaging deals swooning from 21 to 10.

This decline played out against a backdrop that saw U.S. GDP fall 5 percent in the second quarter, with an astonishing loss of 40 percent or more expected for the second quarter, as COVID-19 shutdowns affected global trade. The Dow Jones Industrial Average also fell more than 9 percent in the first half of 2020, with the broader S&P 500 down more than 3 percent.

PMCF Managing Director John Hart said the strong July totals were an encouraging sign. "Buyers are getting more confident with post-COVID-19 conditions," he added.

Unexpected delays

Many first-half delays occurred on plastics M&A deals because of financial uncertainty, inability to travel and reduced access to financing.

"There was some material impact on financial results," Hart said. "You don't want to take your business out [to market] if your sales are down 30 percent.

"A good adviser would say not to launch a deal in that environment. And some deals were stopped in the middle of the process."

"If you have no valuation metrics, how do you value a business?" asked Thomas Blaige, chairman and CEO of Blaige & Co. in Chicago. "The pandemic was the first shoe to drop on uncertainty."

A general lack of financial information and buyers not being comfortable with earnings data during the pandemic delayed many deals, according to Bill Ridenour, owner of Polymer Transaction Advisors Inc. in Foxfire, N.C.

"Buyers are going to hold on to their money if they don't know what's going to happen," said Peter Schmitt, managing director at Montesino Associates LLC in Wilmington, Del. "They don't know what the virus will do next and they don't want uncertainty. If they think the economy is going to struggle and consumers aren't consuming, they might not do as many deals."

Even deals that were already in process were halted if a target company suddenly had to close its plants because of the pandemic, added David Evatz, managing director with Stout Investment Banking in Chicago.

Financial firm Grace Matthews Inc. of Milwaukee advised on four deals that closed in the second quarter. Managing Director Andrew Hinz said that the common thread among those deals was "a strong strategic fit between the acquirer and the target."

"As we move into the back half of 2020, we're seeing some prior processes restart and are sensing that overall deal activity is beginning to increase," he said.

Private equity firm MPE Partners of Cleveland is "actively looking for more deals" but saw fewer opportunities as the second half rolled on, partner Matt Yohe said. MPE's portfolio includes injection molder Plastic Components Inc. of Germantown, Wis.

"June was better than April and May," Yohe said of the M&A market. "When you're looking to make an investment, you never perfect certainty, but we're looking for more certainty than we have right now."

Can't get there from here

Travel restrictions put in place by many companies played a role in the reduced number of first-half deals.

"Even for deals that were going well, the logistics of not being able to meet with an ownership team caused some uncertainty and led to some deals being put on hold," said Evatz at Stout.

"For some of the deals that were delayed, it was a combination of not being able to travel and not being confident in financial projections," added Phil Karig, managing director with Mathelin Bay Associates in St. Louis.

For manufacturing deals, "I still think you need to kick the tires and be there in person," said Andrew Petryk, managing director with Brown Gibbons Lang in Cleveland. "Some deals already had made management presentations prior to the cutback on travel, and those were the ones that moved ahead."

Rick Weil, managing director with Mesirow Financial in Chicago, agreed. "You can have a Zoom meeting and walk through a plant and show a buyer everything on an iPad, but it's not the same as the buyer walking through," he said.

"Everyone has become very proficient at Zoom," added Yohe at MPE. "That's part of the new normal. But for a brand-new investor to build a relationship with an owner, that's an element that needs to be done in person."

Markets in a pandemic

Although deal volume was down almost across the board, some end markets have fared better during the pandemic and could make attractive acquisition targets later in the year. But others — especially automotive — could face a long road back from near-total shutdowns.

"We're working with a couple flexible packaging companies now that have seen their sales go up 50 percent," Blaige said.

"Compounding is coming back," said Ridenour at PTA. "The economy has recovered quickly for those companies."

Andrew Munson, a partner with MBS Advisors in Florence, Mass., listed auto, construction, restaurant supply and big-box retail as markets that "got hit" in the first half. He cited medical devices, film, personal protective equipment (PPE), food packaging and single-use containers as markets that did well.

Medical — including pharmaceuticals — posted good results in the first half, as did packaging in general, Weil said.

"There's still value in a lot of plastic markets like medical and food packaging," said Karig at Mathelin Bay. "But automotive became the poster child for businesses that were hit hard by the pandemic."

In flexible packaging, Montesino's Schmitt said that there could be "a big play" in the second half on medical masks and on innovative packaging for vaccines.

Look out for falling prices

Lower financial results could lead to lower multiples or lower sales prices in plastics M&A. Prior to the pandemic, many plastics deals were closing in multiples of high-single digits or higher. If those numbers go down, the timing of some deals could be changed.

"Valuations do need to come down a little, but it takes a while for sellers to adjust their expectations," MPE's Yohe said. "If an owner saw a competitor sell before for more than what he's being offered now, he's not happy."

Buyer and seller would have to agree on the pandemic being "an unusual event," Evatz said, in order for it not to impact a valuation. Weil at Mesirow said that "there could be a period of readjustment" if sellers are expecting higher prices.

Depending on end market, Munson at MBS said that multiples and valuations in the remainder of 2020 could be down 0.5 to 1.5 turns. "It's a question of whether an owner will take a reduction in price or wait to get paid what he thought he was going to get," added Hart at PMCF.

Several financial pros said that deals could see longer earn-out periods, with owners staying on to get a better overall price if financials improve. "An owner can get a longer earn-out in case the sale process doesn't work out as well as he expected," said Ridenour at PTA. "But buyers also can walk away and then come back. Buyers and sellers are all in the same boat with the economy."

Weil added that business owners "are always optimistic. … They might choose to stay and get their numbers up." At Montesino, Schmitt said that "if a seller thought he was going to get a 12x multiple and he's now being offered 6-7x, he's kicking himself."

A seller could use an earn-out "to bridge the uncertainty gap," said Yohe at MPE. "But a lot of owners will be content to wait [to sell] until the market stabilizes."

Private equity in a bind

Another first-half trend identified by financial pros was the resurgence of strategic buyers from within the industry, when compared to private equity (PE) buyers who had been making up a larger portion of total deals in recent years.

PMCF data showed that PE activity in plastics and packaging declined in the first half for the first time in five years, dropping from 74 deals in the first half of 2019 to just 43 in the first six months of 2020. Company officials said that decline was likely affected by PE's reliance on new financing for successful closings.

"Credit markets are challenged right now, and financing is less of an issue for strategic buyers," Hart said.

Blaige was more blunt in his assessment. "Private equity ran scared in the first half," he said. "It was like they saw an alligator and got out of the pool."

PE firms "were looking for reasons to walk away," Blaige added. "Strategics had lines of credit and access to capital and said, 'Let's do a deal.'"

Karig said that healthy strategics "usually have an advantage in a market like this — they're more able to push out of the gate really hard."

Most PE funds were in "triage mode" during March and April, said Hinz at Grace Matthews, as they focused almost entirely on shoring up their existing portfolios.

"Most private equity M&A activity we've seen in recent months is the 'add-on' variety instead of new platforms, partly due to scarcity of new platform opportunities coming to market, but also due to a more challenging leverage environment."

Generally speaking, he added, companies that emphasize M&A efforts "now are likely to emerge from the pandemic in a better position than those that don't, and many strategic buyers are realizing this."

Others said that PE's retraction from plastics M&A might be a temporary thing. "Over the last 20 years, private equity has become more influential," said Munson at MBA. "We're in an extended period of low interest rates and it's hard to generate other returns, so there's lots of private equity."

"All private equity firms like high growth and confidence, and they know how to take calculated risks," said Weil at Mesirow. "They're not going away."

Hinz also sees a possible rebound for PE. "Private equity firms continue to have a significant amount of capital to deploy, and they're in the business of getting deals done," he said. "Private equity investors also excel at creative deal structuring that should allow them to continue to close transactions even in a more challenging market."

At PE firm MPE, Yohe said that debt financing is still available to PE firms, and those that weather the pandemic well "are well positioned to compete vs. strategics."

Dress for distress

Market watchers also are expecting some distressed deals to be seen in plastics M&A, as happened in the previous economic downturn of 2007-10.

One such deal already took place in the first half, when injection molder Revere Plastics Systems Inc. bought two U.S. injection molding plants from financially troubled Techniplas LLC for just over $2 million. Revere is owned by French PE firm Ardian. The deal was made about a month after Techniplas had filed for bankruptcy.

"We will run those as Revere facilities, rather than just taking the equipment and moving it elsewhere," Revere Sales and Marketing Vice President Doug Drummond said at the time. "I like the idea of keeping these plants open, as well as our own continued growth."

BGL's Petryk described the Revere-Techniplas deal and similar deals as "capacity plays" where one manufacturer essentially is buying production capacity. "We could see more of that type of deal," he said. "It's a fact of life that in a market like this, some companies aren't going to survive."

If an economic rebound doesn't happen and companies break bank covenants, more defaults will be seen in the market, added Evatz at Stout. PE-backed companies with large debt loads also might decide to get more equity or raise capital through asset sales, Weil said.

"There could be a lot of distressed deals," Munson at MBS said. "We're talking to companies that are struggling."

"If sales targets and earnings drop, distressed deals could come out of it," said Ridenour at PTA.

Distressed deals also could raise the overall volume of deal activity in plastics M&A, according to PMCF's Hart, even if prices in those deals are lower.

The big decision

Deciding whether to sell or not always has been a difficult moment for plastics business owners. The COVID-19 pandemic has made that decision even more challenging.

"Unless there are other factors like family needs, a lot of owners are going to delay plans in order to not take a material hit on their valuation," Hart said. MPE's Yohe added that "if an owner has a long-term horizon, he can wait for things to settle down."

Other financial pros said the pandemic might change the time frame for owners approaching retirement.

"Some owners have seen that a natural disaster like a pandemic can bring everything they've built down in a second and they want to sell," Blaige said. Munson added that "a lot of older owners need to sell. … COVID-19 has been a catalyst to get people thinking of an exit strategy."

Evatz at Stout said that some owners "may not be able to wait" because of their financial situations.

Ultimately, owners need to decide "if they're running a fire sale or if they're an essential business," according to Karig at Mathelin Bay. "Some might want to cut their losses and run, but some might dig in their heels to get a better price," he said.

Finding a forecast

Visibility to the second half — or even to the next month — of 2020 is extremely low, but financial pros took a crack at it anyway.

M&A transactions "will continue to get done, although we are unlikely to see deal levels reach those seen in recent years for some time," Hinz of Grace Matthews said. "With organic growth relatively stagnant in most end markets, companies will continue to turn to M&A as a way to bolster growth that shareholders demand."

Now more than ever, he added, "running a tight, competitive sale process will be critical in generating an optimal outcome for a seller."

"If we don't get a [COVID-19] vaccine and the virus spikes later this year, things are going to be rough," Schmitt of Montesino said. "We've already seen a bull and a bear market this year — this could be a bronco market."

Hart pointed out that the second half could see "a lag in data," with deals that normally would have closed in the first half, closing in the second half instead. "The second half might not be back to normal activity, but we should see more deals if there isn't a second wave," he said.

The plastics M&A downturn might be "relatively short-lived," according to Ridenour, but at the same time the market is subject to "a lot of political and social volatility."

At Mesirow, Weil was fairly optimistic. "I think the summer will be slow, but after Labor Day, people will get back at it and deal announcements will pick up," he said.

Blaige also sounded confident. The effects of COVID-19 "might be a bubble," he said. "I don't think it will have any long-term structural impact on the market."

M&A

Continued from Page

Inline Play
