

Test & measurement and industrial automation

Key market drivers

The Test & Measurement and Industrial Automation (T&M / IA) sector ended 2019 with strong financial results. Approximately 50% of the peer group achieved record revenue results. However, as a result of COVID-19, economic activity and demand within the sector significantly decelerated in the first few months of 2020 and into Q2.

Market response appears consistent with the spread of the virus, with the negative impact in North America and Western Europe trailing that of China. Stock price performance across the sector was correlated with that of the broader market, with a sharp decline in late March, a rebound in April and May and volatility returning in June.

Many T&M / IA served markets – most notably healthcare, food and beverage, energy, communications, infrastructure and defense – were deemed essential businesses and continued to operate through shelter-in-place orders in many regions of the world.

In Q1 and into Q2, companies within the sector responded to COVID-19 primarily by focusing on employee health and safety while ensuring business continuity for ongoing operations. Other priorities included maintaining financial strength, flexibility and liquidity as well as preparing their cost structure for the challenging environment ahead.

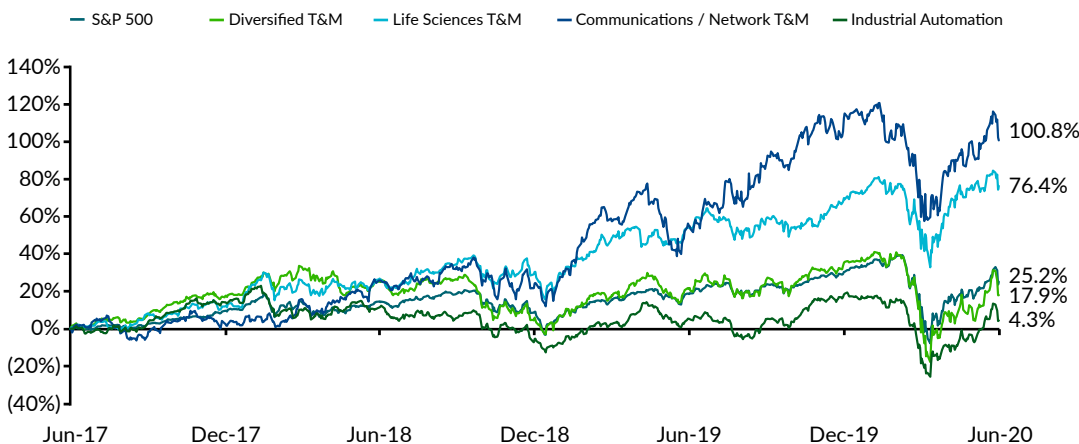


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CHART 1: INDEX PRICE PERFORMANCE: TEST & MEASUREMENT AND INDUSTRIAL AUTOMATION¹



Source: FactSet as of June 12, 2020. Past performance is not indicative of future results. Please see page 4 for important information.

M&A overview

Understandably, market volatility resulting from the spread of COVID-19 slowed deal activity. Through Q1, strategic buyers shifted resources from M&A activities to internal initiatives, while financial sponsors focused on supporting portfolio companies and their management teams.

During the second quarter, buyers began to look past the near-term and shifted focus back to M&A pipelines. Of particular interest are assets with exposure to longer term sector dynamics, and demand drivers less subject to fluctuating economic cycles:

- Healthcare and life sciences applications fueled by a growing middle class and an aging population
- Automation that can enhance productivity and support long-term sustainable economic momentum
- Products that boost data usage and speed for both consumer and industrial applications
- Continued prioritizing of R&D and innovation
- Solutions that support adherence to higher product quality standards which are increasingly driven by consumer advocacy and regulatory requirements
- Products and services that enhance QA to reduce risk and product recalls

Select Mesirow advised M&A transactions

- **Exclusive financial advisor to Artemis Capital Partners on the sale of its portfolio company Adcole Maryland Aerospace (AMA) to AE Industrial Partners.** AMA specializes in the design, manufacture, integration, test, and operation of spacecraft components and small satellites, combining new space technologies with a rich heritage in space flight and proven traditional space hardware to meet the emerging needs of the aerospace industry. AE Industrial Partners is a private equity firm specializing in aerospace, defense, government services, power generation and specialty industrial markets.
- **Exclusive financial advisor to Meggitt PLC on the sale of its Endevco assets to MTS Systems Corporation (MTS).** Endevco is a leading provider of high-performance sensors and related accessories used for precise vibration, shock, temperature and pressure measurements. MTS Systems Corporation's testing and simulation hardware, software and service solutions help customers accelerate and improve their design, development and manufacturing processes and are used for determining the mechanical behavior of materials, products and structures. MTS' high-performance sensors provide measurements of vibration, pressure, position, force and sound in a variety of applications.
- **Exclusive financial advisor to Midtronics, Inc. on the divestiture of its Stationary Power Division (SPD) to Franklin Electric Co., Inc.** SPD is a market-leading provider of industrial battery testing and remote monitoring equipment, software and services for mission critical applications, providing critical power reliability, compliance, operating efficiency and business intelligence to customers operating in the telecom, data center and electric utility markets. Franklin Electric is a global leader in the production and marketing of systems and components for the movement of water and fuel.
- **Exclusive financial advisor to Zenith Supply Company (Zenith) on its sale to AIV, Inc.** Zenith Supply is a master distributor of slow-moving, mission-critical industrial steel and special alloy valves manufactured by Velan, Inc., a world leader in the design and production of cast and forged severe service valves and stream traps across all major industrial markets. AIV, Inc. is a global master distributor of high-quality valves and actuators, selling through distribution only.

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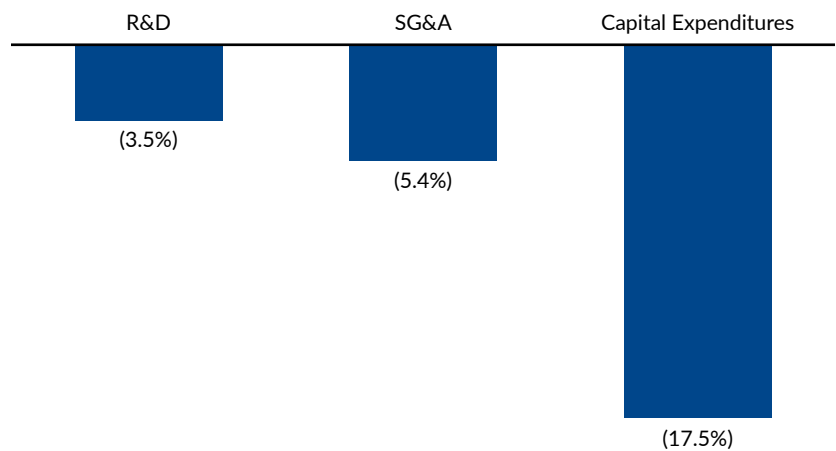
Indicators to watch

The T&M / IA sector is generally influenced by key macroeconomic variables such as the Purchasing Managers' Index (PMI), R&D investment, industrial production, capacity utilization and government expenditures

The full economic impact of COVID-19 is still unknown and not yet entirely reflected in most economic measures. Given the lack of visibility, many companies have suspended earnings guidance for 2020. Nevertheless, some indicators can still prove useful.

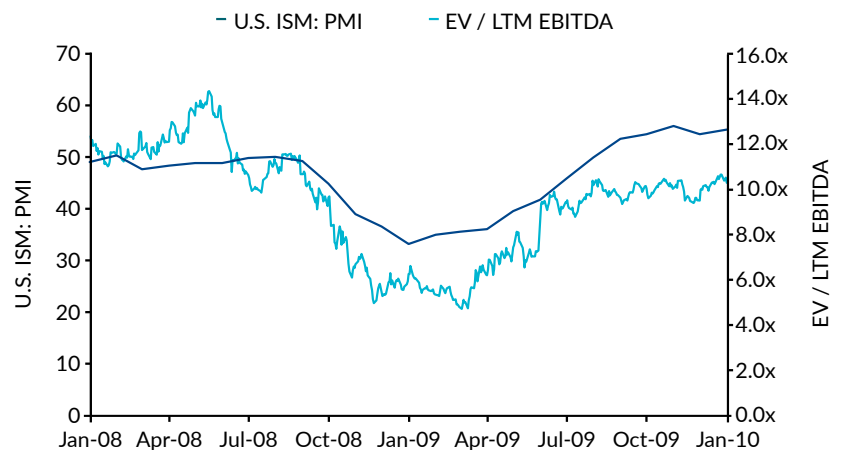
- R&D and Capital Expenditure Spend:** Markets and customers served by T&M / IA firms typically maintain their R&D spending, particularly on projects contributing to organic growth that position them to benefit as demand normalizes and for the longer term. However, equipment purchases are typically delayed as mission critical operating expenses are prioritized over larger capital investments. Looking back at 2008, R&D spend declined by approximately 3.5% compared to a capital expenditures decline of 17.5%.
- Industrial Production and Purchasing Managers' Index:** Economic activity in the manufacturing sector contracted in Q1 with a decline in industrial production of 5.5%. The U.S. economy contracted after 131 consecutive months of expansion. According to the Manufacturing ISM, April PMI was 41.5%, down 7.6% from March while May was 43.1%, a 1.6% increase over April. Consistent with the broader equity market, T&M / IA equity performance and valuation has decoupled from most economic variables. Looking back at the last recession, valuations closely tracked PMI, and multiple expansion within the sector began once the PMI hit a floor.

CHART 2: COST REDUCTIONS (2009 VS 2008)



Source: Booz & Company Global Innovation 1000 annual study, 2009. Cost reduction results based on 1,000 public companies that spent the most on research and development during the study period.

CHART 3: U.S. ISM: PURCHASING MANAGERS' INDEX VS. EV/LTM EBITDA – DIVERSIFIED T&M INDEX (2008-2009)



Source: FactSet. Past performance is not indicative of future results. Diversified T&M Index: AMETEK, Inc. (NYSE:AME), Danaher Corporation (NYSE:DHR), ESCO Technologies Inc. (NYSE:ESE), FARO Technologies, Inc. (NASDAQ:FARO), Hexagon AB Class B (STO:HEXA-B), Itron, Inc. (NASDAQ:ITRI), Landis+Gyr Group AG (SIX:LAND), MKS Instruments, Inc. (NASDAQ:MKSI), MTS Systems Corporation (NASDAQ:MTSC), National Instruments Corporation (NASDAQ:NATI), Oxford Instruments plc (LSE:OXIG), Sensata Technologies Holding PLC (NYSE:ST), Spectris plc (LSE:SXS), TE Connectivity Ltd. (NYSE:TEL), Teledyne Technologies Inc. (NYSE:TDY), Teradyne, Inc. (NASDAQ:TER), Xylem Inc. (NYSE:XYL).

Outlook

The fallout from COVID-19 will most likely delay investment until corporations regain confidence in the global economic outlook. For buyers and lenders, it has introduced another dimension of risk to due diligence. Despite the near-term impact, several dynamics should continue to drive long-term M&A activity within the T&M / IA sectors:

- Strategic buyers will continue to use M&A to fill “white space” across solution portfolios, geographic footprint and end markets
- M&A is a tool to fill portfolio gaps and support a solutions-based go-to-market strategy. Customers demand fully integrated solutions to acquire / analyze / visualize data to support operational decisions
- Strategic buyers are acquiring businesses that provide solutions to complement equipment and product sales
- Consumer advocacy and regulatory requirements mandating an increase in quality standards
- More value being encapsulated in software, service and recurring revenue / cash flow
- Predictable, recurring revenue offsetting cycle-driven equipment sales

Financial buyers most likely will continue to invest in the sector given its attractive business and financial characteristics. The T&M / IA sector is fragmented and provides opportunities to execute a buy-and-build strategy to develop platforms of scale.

- Private equity roll-up strategies due to lack of meaningful targets of scale
- Partnering with industry executives to execute / operate platforms

Ultimately, all these factors will likely support continued M&A activity within T&M / IA. The question is how long the current disruption will last.

Dedicated advisor to the industrial technology sector

Mesirow Investment Banking is consistently focused on elevating the experience for our clients. With extensive sector-specific expertise and deep long-standing relationships, our dedicated industrial technology team has a proven track record of completing highly tailored and successful transactions. Our highest priority is helping individuals and organizations achieve their financial and strategic goals.

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1 Diversified T&M Index: AMETEK, Inc. (NYSE:AME), ESCO Technologies Inc. (NYSE:ESE), FARO Technologies, Inc. (NASDAQ:FARO), Fortive Corp. (NYSE:FTV), Hexagon AB Class B (STO:HEXA-B), Itron, Inc. (NASDAQ:ITRI), Landis+Gyr Group AG (SIX:LAND), MKS Instruments, Inc. (NASDAQ:MKSI), MTS Systems Corporation (NASDAQ:MTSC), National Instruments Corporation (NASDAQ:NATI), Oxford Instruments plc (LSE:OXIG), Sensata Technologies Holding PLC (NYSE:ST), Spectris plc (LSE:SXS), TE Connectivity Ltd. (NYSE:TEL), Teledyne Technologies Inc. (NYSE:TDY), Teradyne, Inc. (NASDAQ:TER), Xylem Inc. (NYSE:XYL).

Life Sciences T&M Index: Agilent Technologies, Inc. (NYSE:A), Becton, Dickinson and Company (NYSE:BDX), Bio-Rad Laboratories, Inc. (NYSE:BIO), Bio-Techne Corporation (NASDAQ:TECH), Bruker Corporation (NASDAQ:BRKR), Danaher Corporation (NYSE:DHR), Mesa Laboratories, Inc. (NASDAQ:MLAB), Mettler-Toledo International Inc. (NYSE:MTD), PerkinElmer, Inc. (NYSE:PKI), Sartorius AG (FWB:SRT), Thermo Fisher Scientific Inc. (NYSE:TMO), Waters Corporation (NYSE:WAT).

Communications / Network T&M Index: Advantest Corp. (TSE:6857), Anritsu Corporation (TSE:6754), EXFO Inc. (NASDAQ:EXFO), Keysight Technologies Inc. (NYSE:KEYS), NetScout Systems, Inc. (NASDAQ:NTCT), Spirent Communications plc (LSE:SPT), Viavi Solutions Inc. (NASDAQ:VIAV).

Industrial Automation Index: ABB Ltd. (SIX:ABBN), ATS Automation Tooling Systems Inc. (TSX:ATA), Cognex Corporation (NASDAQ:CGNX), Emerson Electric Co. (NYSE:EMR), FANUC (TSE:6954), FLIR Systems, Inc. (NASDAQ:FLIR), Honeywell International Inc. (NYSE:HON), Keyence Corporation (TSE:6861), KION GROUP AG (FWB:KGX), Lincoln Electric Holdings, Inc. (NASDAQ:LECO), OMRON Corporation (TSE:6645), Rockwell Automation, Inc. (NYSE:ROK), Schneider Electric SE (Euronext:SU), Siemens AG (FWB:SIE), Yaskawa Electric Corporation (TSE:6506), Yokogawa Electric Corp. (TSE:6841).