

NEW RULES OF THE GAME IN INDUSTRIAL AUTOMATION MERGER ENDGAME



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With all the megatrends like Industry 4.0, industrial automation should have been seeing a sharp increase in corporate acquisitions for a long time. Now the industry is probably growing even faster, fueled by the Corona pandemic, with no end in sight. However, this has already been the case in recent decades. Nevertheless, with the exception of a few small start-up transactions and inevitable succession plans, only a few corporate acquisitions were observed. So why was this the case? Does this observation also apply to the present and the future? Is now the time for industry consolidation? These are the questions we answer in this article.

We describe what we mean by industrial automation and how we segment it. We present the rules of the game of the individual segments and elaborate on their commonalities, which in turn explain why the M&A market in industrial automation has been largely so sluggish and so inactive compared to other industries. Finally, we assess the degree of industry consolidation before charting the implications for the acting entrepreneur.

Due to the diversity of applications, products and services, segmentation is a challenge and can never be perfect. However, after a thorough analysis, four rough segments can be identified within industrial automation:

1. **Sensors, Measuring and Testing Technology:** this segment comprises sensors and associated components for measuring

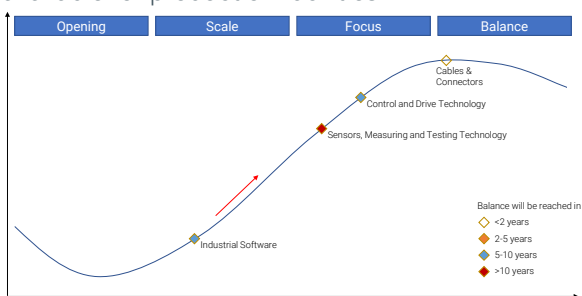
and processing physiochemical parameters: Mechanical and electronic sensors, (electro-)magnetic sensors, MEMS, optical sensors & cameras, acoustic sensors, (bio-)chemical sensors and others.

2. **Cables & Connectors:** This includes all connection technology between the individual machine components. This segment is highly standardized and competitive.
3. **Control and Drive Technology:** This segment comprises electric motors and actuators, industrial control systems (PLCs) and control components. Here, too, the business is strongly component-heavy.
4. **Industrial Software:** This fast-growing market, which also extends into the service sector, is made up of software for numerous applications: Shop Floor (MES), ERP, PLM, Logistics & SCM and implementation services. The market is young and characterized by strong M&A activity.

Of course, we are aware that this does not cover all areas of automation. However, many other segments consist of combinations of the above, including power supplies, routers & switches, robotics & handling equipment, displays, HMI, input devices, control cabinets, industrial PCs & embedded systems and many more.

What do all these segments have in common or what are the overall characteristics of industrial automation? To understand this, it is important to

understand that each automation solution implemented is ultimately a unique solution for a specific company. Each company, each site, each production has its own specific requirements. As a result, there is an unmanageable number of niche products, niche solutions and thus niche suppliers, whose "hawker's trays" all have their reasoning. It is a wonderful field for engineering-driven family businesses to occupy niches. The number of smaller and medium-sized family-owned companies in industrial automation is therefore very high, and there are only a few giants such as SIEMENS among them. However, being "engineering-driven" is probably also a reason why the German-speaking region, along with Japan, is so strong worldwide. For example, 20 of the 25 leading sensor companies are based in the DACH region and two of the largest in Japan (Keyence and Omron). The U.S. and China still play a rather subordinate role, whereby the emphasis here is explicitly on the "still". Another reason for the strength of the DACH region and Japan is perhaps the scarcity of space available for production facilities.



New automation solutions are usually introduced with new production facilities and are linked to the correspondingly long investment cycles. A standstill of current production and its retooling would not be acceptable and consequently explains the high quality requirements placed on automated productions. Certainly, this is one reason why the industry as a whole can be described as very conservative.

All these characteristics have led to the fact that in industrial automation there are a large number of family-owned companies which, in their respective niches, have so far enjoyed a wonderful business environment with high single-digit annual growth, and for which there was thus no reason to sell unless there was a compelling family reason: hence the low number of transactions in industrial automation so far.

However, the rules of the game have changed:

- > Global standards are being defined, and no longer just by the automation companies.
- > New manufacturing concepts are in demand, allowing high product flexibility.
- > Shorter investment cycles.
- > Continuous digitalization.
- > New products and solutions require fast/rapid global marketing to realize depression effects as quickly as possible.

M&A dynamics in industrial automation would therefore have to increase significantly. Let's now take another step back and transfer our segments to the so-called merger end-game graph. It shows the degree of industry concentration over time, assuming that each industry consolidates.

Sensors, Measuring and Testing Technology

Consolidation has begun. The large sensor suppliers, such as SICK AG, are growing faster than most smaller suppliers (< EUR 100 million in sales). The fact that financial investors are increasingly entering the market is also a clear sign of increasing industry consolidation.

For example, at the end of 2019, the industrial holding company ADCURAM made an investment in automation with the STEINEL Group, an international supplier of sensors, sensor lights, hot air devices and industrial components. The strategic focus is on joint growth, particularly in building intelligence and through internationalization. The parties have agreed not to disclose the purchase price.

Cables & Connectors

ODU (Markt & Technik, 13/2021, GF Denis Giba and Thomas Irl): "We never participate in standardization solutions." The focus at many connector manufacturers is on customized solutions. Once the company is "designed in", often as a single source, it is a stable profit generator over the entire product life cycle. However, this approach is hardly viable in industrial automation. A good example in this respect is medical technology, which no longer offers any space for niche suppliers due to a very high (production) volume.

Control, Regulation and Drive Technology

While there have long been two dominant suppliers in the field of control systems, Siemens and Fanuc, drives are currently undergoing consolidation due

to higher volumes, new technical standards and interface definitions.

Industrial Software

Industrial software is in the phase of accumulation with many venture investments or start-up transactions. For example, Bachmann recently announced the acquisition of German tech start-up Indalyz Monitoring & Prognostics (IM&P), founded and led by physicist Professor Michael Schulz. Prof. Schulz and his team of experts specialize in the development, implementation and operation of intelligent monitoring software. The acquisition of Lantek by Trumpf, which thus focuses on software in sheet metal processing that runs independently of the machine manufacturer, also underscores this trend. It is obvious that software know-how is necessary for almost every company in industrial automation, hence the increasing number of small acquisitions. What is still missing is the entry of the giants, who are still waiting until the market structures have become clearer or until scalable, sustainable areas or platforms have been established.

To put it bluntly, shareholders of companies in the automation sector have only two options: either to buy or to sell. The exclusively organic form of growth that has prevailed for decades is no longer a sustainable option. Growth alone does not equal success, but only stronger growth compared to competitors.

Admittedly, this conclusion is very polarizing and on top of that, comes from an M&A consulting firm. There will certainly always be niches in which companies will continue to survive for decades and generate high returns. Also, the duration of the "merger endgame" cannot be determined by anyone. Moreover, automation, with its multitude of customized business solutions across many industries, is and has always been a rather tough industry in terms of the speed of change.

But even automation cannot escape the merger endgame - "every industry consolidates" - in the long run. All the signs of increasing dynamization speak for this: the stronger growth of the "big players", globalization, the entry of industry outsiders and financial investors.

What options do I have now as an entrepreneur? Be open to M&A, the supreme discipline of corporate strategy. Watch M&A transactions closely: who is buying whom, for how much and why? Don't see

M&A as a threat to your company, as an unpleasant topic, but as an opportunity, as an integral part of your corporate strategy.

But what are the implications of this increasing industry consolidation for the entrepreneur? We expressly emphasize that this must be examined specifically for each individual company.

The fact that the characteristics within the individual segments of industrial automation differ has been sufficiently explained in this article. For a product company, the rules of the game have a different impact than for a solution provider; and for a sensor manufacturer occupying smaller niches, again different than for the sensor manufacturer offering high-volume sensors.

Certainly, there will continue to be companies with a limited number of customers who will continue to rely on a vendor's specific solution and its further development. But for most companies, this is not true. For the majority, it is urgent to address the issue of M&A and partnerships. An investor does not buy the beautiful past and the actual figures, since these still belong to the current shareholder, instead he buys future results. He acquires the future of the company. The question is whether every company has the strength to maintain the good results and implement the necessary steps (keyword globalization or digitalization)?

M&A has clearly arrived in industrial automation.

Or as Christian Wolf (Managing Director of the Turck Group) puts it: *"Our founder-driven company always wanted to grow organically, not make any acquisitions and do everything ourselves. But digitization does not give us the time for that! If you want to build up the software completely on your own as a hardware supplier, you can no longer keep up with the dynamics of the market."*

About Aquin

In-depth industry knowledge

Aquin has specialized in the automation industry for more than 10 years with a number of successfully completed transactions. The automation team at Aquin is led by Jürgen Kuttruff, who was also previously responsible for sensor technology at Infineon. Acquisitions ("Who buys whom, why and for how much?") are continuously analyzed.

Direct contact with decision-makers

Aquin works successfully with leading large companies, medium-sized companies and financial investors and has access to the decision-makers of companies in the automation industry.

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