

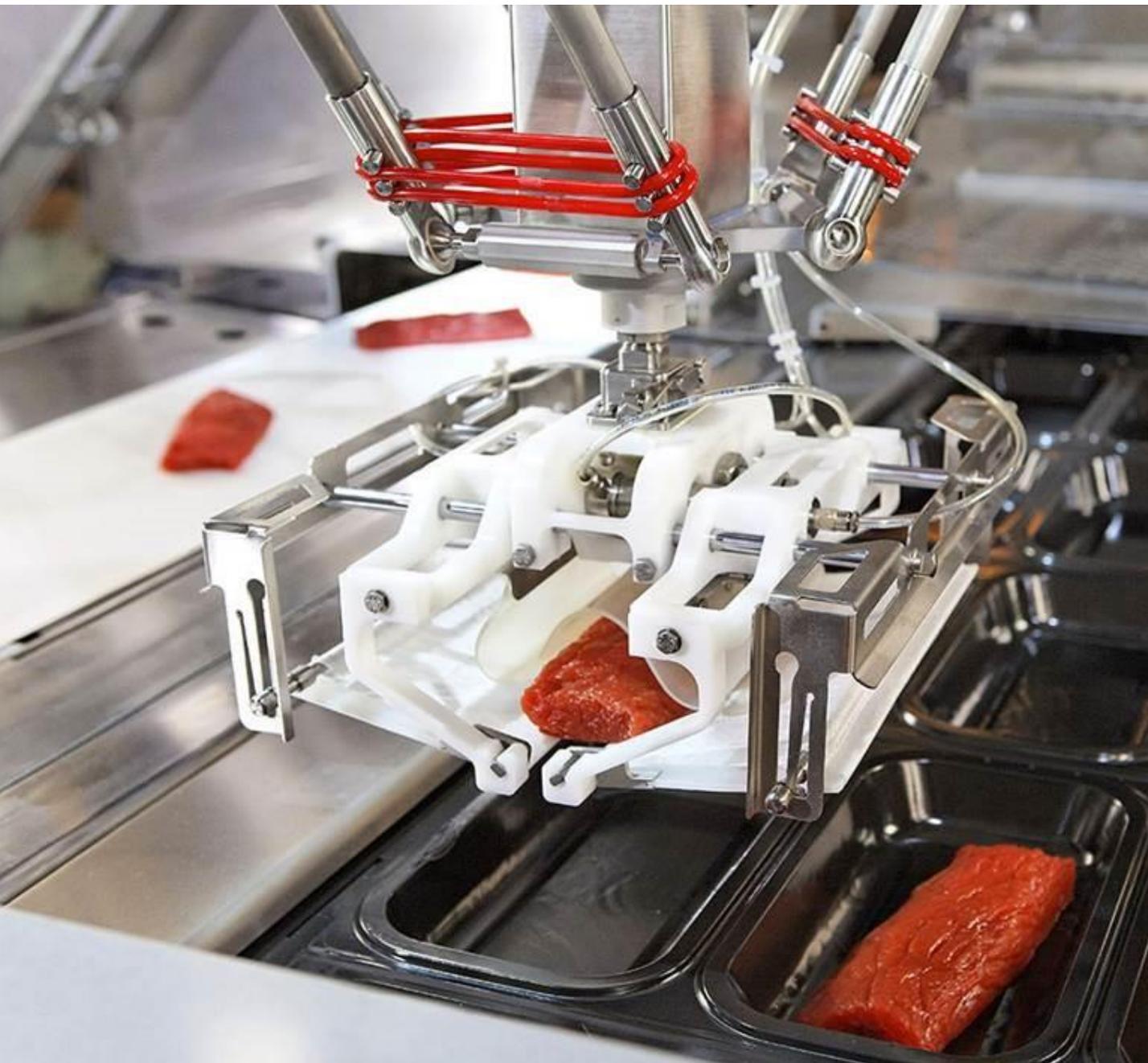


HOULIHAN LOKEY

PACKAGING AND PROCESSING MACHINERY

MARKET UPDATE | COVID-19

April 2020



Packaging and Processing Machinery

Current Market Overview

The outbreak of COVID-19 has resulted in a global health emergency and caused significant disruption to the financial markets. Houlihan Lokey presents a preliminary assessment of the impact of the virus on the packaging and processing machinery sector.

Market Update, Part 1 of 2

While no one can predict at this point the full impact of the COVID-19 pandemic on the world economy, or how long the situation will continue, it is certain, in our view, that it will impact the packaging and processing machinery sector in a significant way.

E-Commerce

It is evident that e-commerce is experiencing a big boost. The trend towards online shopping will accelerate even further, including product categories that have not been distributed through online channels at a significant scale to date (e.g., fresh food).

- This acceleration of e-commerce is evidenced by recent news that Amazon plans to hire 100,000 extra workers in the US to manage e-commerce demand.
- We foresee that COVID-19 will have a permanent effect on shopping habits. Because many people are currently turning to online shopping who didn't have the habit before the crisis, including older age groups, it is likely that they will stick with it forever.
- It will thus be paramount for companies to set up a home delivery business model and develop their e-commerce distribution channels, if not already done yet, in order to stay competitive.

Supply Chain Risk

The COVID-19 pandemic has revealed the vulnerability of global manufacturing setups, which are significantly exposed to supply chain concentrations, either geographically or from a single-source supplier perspective.

- Going forward, it will be important to avoid clustering suppliers in one region, particularly around similar supply chains. Diversifying supply chains across geographic regions is the only way to guarantee that operations compromised in one region can continue to operate in another. Companies may look beyond selecting locations based on lowest price in order to consider a location's overall value and risks in the supply chain. Some of this has actually already been taking place over the last year because of trade and tariff conflicts, as many companies have found that their operations were overextended in China.
- Capabilities to operate remotely are also becoming more and more critical as the workforce might be inaccessible because of a weather disaster or pandemic.
- Long-term successful operations will therefore be companies that have the tools in place to be flexible and agile as well as those that are able to quickly change runs, control and monitor their factories, adjust their supply chains, and deploy their workforce from any location. These requirements will put more pressure on SMEs, as they have to ensure such capabilities with limited financial resources.

Distribution Channel

The COVID-19 crisis has also scrutinised the traditional distribution model of consumer products.

- It has become a concern how products can be distributed straight to the consumer by reducing the time for products to be tied up in the logistics chain.
- The traditional distribution center model might therefore not be the most efficient way to send products to consumers. Factories will review how they can deliver manufactured products right to the customer. This might fundamentally change the way to package products, because bulk packaging for delivery to distribution centers will not be required anymore. The trend towards omnichannel packaging solutions, to develop a single packaging solution for all sales channels and thus eliminate the entire co-packing stage, will further accelerate.

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Packaging and Processing Machinery

Current Market Overview (cont.)

The COVID-19 pandemic will have a limited impact on the packaging and processing machinery sector as a whole; how much it will affect individual companies depends on their specific end markets and product areas as well as their digitalisation capabilities.

Market Update, Part 2 of 2

Profiting and Loss Segment Overview

While the COVID-19 pandemic will reduce overall packaging volumes during the crisis, across the various packaging formats there are certain subsegments that will experience a boost.

- Sustainability has been the big trend in packaging in the recent past, and many companies have switched to more eco-friendly alternatives, such as replacing plastic materials and removing single-use packaging. COVID-19, however, has caused concern over the health and safety of products that do not use adequate packaging.
- It is therefore likely that there will be an increased demand for packaged goods, especially in the food and beverage category. In particular, single-use aseptic packaging should see a significant rise.
- Plastics have therefore been the material of choice in the medical field for decades, and people live healthier, longer, and better lives because of these materials.
- China's packaging industry could also see tighter packaging regulations. The Chinese government is reportedly considering a change to meat-handling and distribution practices. Such a change will likely result in increased demand for flexible packaging for the meat and fresh-products categories. An increase in consumption through distributing meat in flexible plastic packaging would reduce the risk of future outbreaks.
- Demand for some product categories will change in the long term as well. For instance, the use of cleaning and sanitary products will sustainably increase even after the virus subsides, which will have a positive effect on the corresponding packaging formats.
- Tissue manufacturers are experiencing high demand, as shoppers have been hoarding toilet paper, facial tissue, and paper towels—at some point, however, demand will drop off as people work through their backstock.
- The accelerated rise of e-commerce will see containerboard and corrugated packaging volumes further increase as consumers shop even more from their homes.
- The increase in online shopping for food products that have typically been delivered in returnable plastic crates—possibly seen as prone to carrying the virus going forward—might also result in the use of more disposable (but recyclable) packaging, such as corrugated. All these factors point to tighter containerboard supplies, which will support price increases across the geographies.
- On the other hand, COVID-19 negatively impacts some; for instance, the drop in graphic paper demand and prices due to school closures could potentially lead to additional graphic paper mill closures in Europe.

Manufacturing

On the manufacturing side, the COVID-19 crisis will accelerate the level of automation and digitalisation throughout the supply chain and manufacturing processes. Packaging equipment manufacturers experience a mixed picture dependent on their specific end markets and product areas.

- Generally, order backlogs at packaging equipment manufacturers were high pre-crisis. Supply-chain disruptions and the inability to install and approve packaging lines at customers' sites are causing significant delays in the realisation of turnover.
- Digital transformation will offer manufacturers real-time visibility into the supply chain and give them the ability to be more flexible in times of crises. Some digitalisation tools that provide visibility include digital twins, augmented reality, and virtual reality—features that are already widely used in modern packaging and processing equipment lines.
- Packaging and material handling requirements may change on very short notice. More robots and automation will be required to respond to those kinds of fluctuations—but companies will also need more human talent to manage them.
- Tissue paper and pharmaceuticals equipment manufacturers are currently experiencing high demand for their aftermarket service and spare parts businesses, as production lines are running at maximum output.
- Medium- to long-term outlook is, in our view, certainly positive as the demand for highly automated and flexible production lines with remote service features, such as preventive and predictive maintenance, will further increase.

▶ **One of the major economic concerns is that while the COVID-19 crisis started off as a supply shock, it has the potential to spill over into a demand shock. Such a scenario, which policy makers try to avoid by mobilising unprecedented economic support measures, carries the highest potential economic consequences across all industry sectors.**

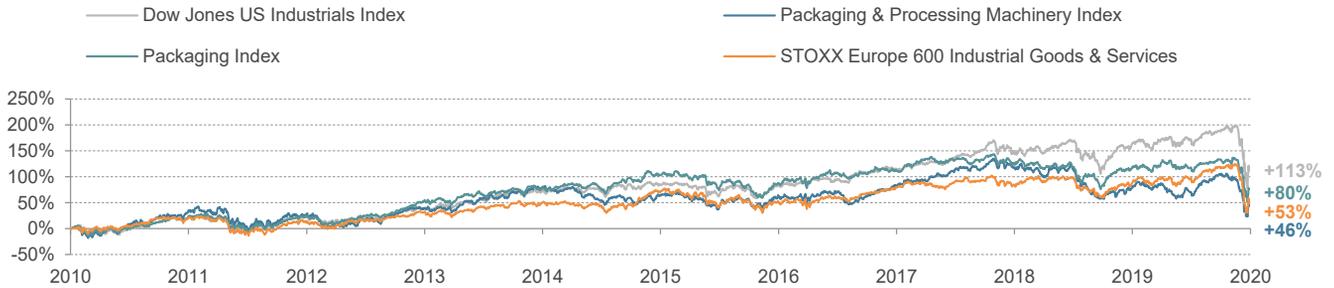
▶ **At this point it is, in our view, safe to say that no one is currently able to predict exactly how the COVID-19 pandemic will turn out. But it is also evident that when this crisis does subside, the old normal will not be the new normal.**

Packaging and Processing Machinery

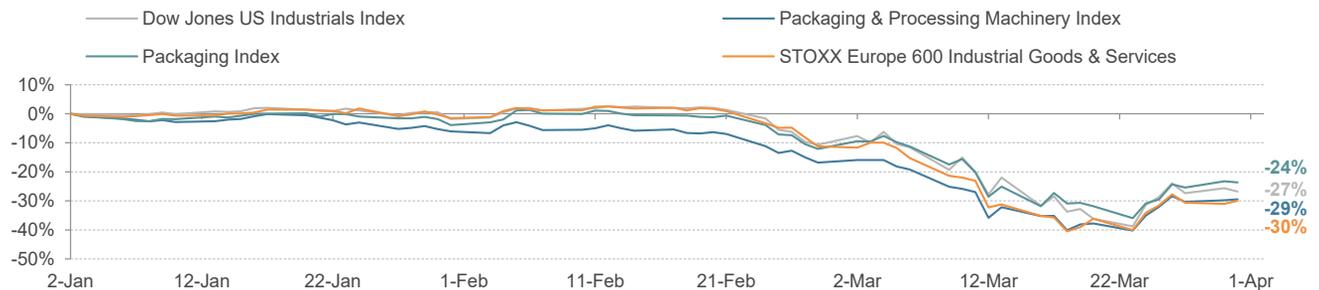
Public Markets and Sentiments

The packaging and processing machinery sector comprises companies that serve a great variety of end markets of favorable growth and stability characteristics, resulting in less volatile share price performance.

Long-Term Market Performance – Last 10 Years



Recent Market Performance – YTD 2020



Comments

- The COVID-19 pandemic hit the international markets hard and caused a significant share price decline of the industrial indexes of c. 30% since the outbreak of the crisis.
- The packaging and processing machinery industry has traded broadly in line with the industrial indexes since the beginning of this year. The packaging industry has, however, experienced a softer drop, as some subsegments and individual companies have withstood the general downward trend well.
- In particular, companies active in paper and board (e.g., corrugated packaging, tissues), metals (e.g., canned food), and rigid plastics (e.g., drug delivery systems) have outperformed the market.
- Overall, it remains to be seen at what valuation level companies in the packaging and processing machinery sector will trade in the “new normal” when revised brokers’ estimates will be available for 2020E anticipating the P&L impact of the crisis in the current year and beyond.

Quotes

March 20: “On average, we are reducing our 2020 and 2021 EBITDA estimates by ~10%/~5% and our price targets by ~20-40%. That said, these are conservative estimates and packaging is arguably one of the most defensive sectors given its participation in “essential” food, beverage, consumer, and healthcare end markets.”
– Royal Bank of Canada Capital Markets

March 24: “A rapid slowdown in overall demand should more than offset any positive effects from (i) increased tissue demand (think toilet paper hoarding), (ii) e-commerce gaining share, and (iii) supply disruptions. As a result, we lower demand and price forecasts for all grades.” – Bank of America Securities

Source: Capital IQ as of 3/31/2020

Notes: Packaging Machinery Index includes G1A, IMA, KRN, BOBNN, MAREL, ALFA, SIGN, JBT, ATA, HI, FLOW;

Packaging Index includes AMC, ITP, HUH1V, SEE, WPK, MNDI, ATR, BERY, GEF, SON, ALGIL, PGH, CAS, GPK, IP, PKG, WRK, SK3, SMDS, ARD, BLL, CCK, OI, SLGN, GXI, NPK, and VRLA

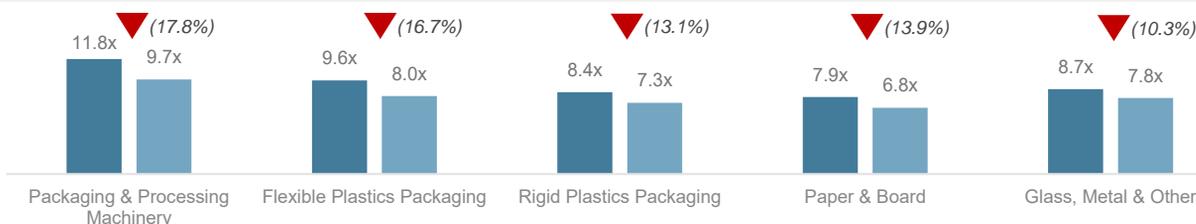
Packaging and Processing Machinery

Public Markets and Sentiments (cont.)

Since the COVID-19 outbreak, valuations in the packaging and processing machinery sector have come down by 14.4% on average across all segments. Some companies with specific dynamics have shown a positive development.

EV/EBITDA by Segment Split and Date

EV/EBITDA 2020E YTD

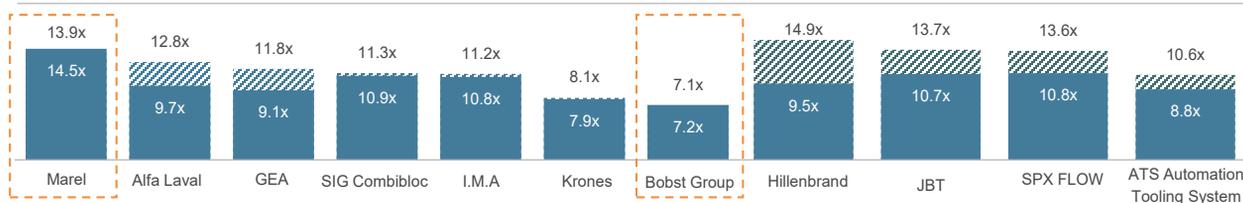


EV/(EBITDA – Capex) 2020E YTD

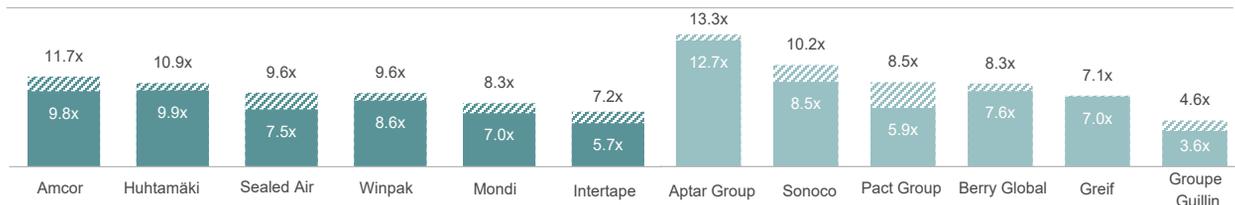


EV/EBITDA by Segment and Company Split

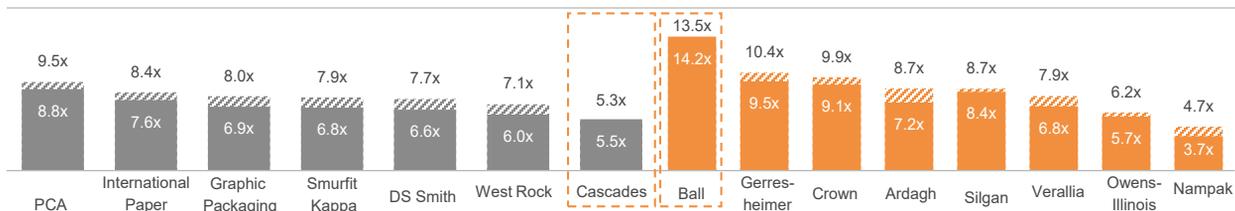
EV/EBITDA 2020E YTD Packaging Machinery



EV/EBITDA 2020E YTD Plastics



EV/EBITDA 2020E YTD Other



Best performing companies with EV/EBITDA multiple growth | Shaded areas refer to EV/EBITDA multiples as of January 2

Questions and Considerations

Volatile market conditions have created many questions for businesses. Houlihan Lokey's significant product and end-market expertise position us to help review a variety of strategic alternatives.

Debt Market Update

Are private credit markets open for new investments?



Private market issuances are open but on a case-by-case basis. Lenders are willing to provide financing but are starting to seek higher yields and more structure on terms (i.e., covenants and definitions).

What are the effects of market volatility on existing credits?



Amidst uncertainty, there has been a recent trend amongst borrowers to draw down on revolving credit facilities to provide additional liquidity. Lenders that hold revolving credit commitments have typically reserved capital to satisfy their obligations in respect to undrawn lines of credit, which is now further supported by pandemic emergency programs (e.g., the \$1.5 trillion repurchase offering implemented by the New York Fed on March 12 as well as a €750 billion Pandemic Emergency Purchase Programme implemented by the ECB on March 18).

Sellers

Are sellers launching new processes?



Sellers are expected to hit pause on new deal launches as companies reprioritise and focus on addressing near-term business needs. That said, a number of existing auction processes are moving forward, but parties are proceeding slowly and cautiously in light of limited financing availabilities with the hope of improved market stability by the time they are ready to sign.

Are valuations going to change fundamentally?



Market volatility will continue to drive depressed valuations as buyers are discouraged by performance, business uncertainty, and deal risks. Recession-resistant businesses and industries may be valued at a premium to market.

Equity Market

How are financial sponsors thinking about portfolios?



Sponsors have shifted focus to addressing near-term business and liquidity needs for existing portfolio companies to weather the storm.

Are financial sponsors looking at new deals?



Many sponsors continue to evaluate new opportunities with a potential setup for a buyer's market. Where target fundamentals remain intact, previously unavailable deals may become actionable at bargain prices if valuations experience a reversion to mean and strategics as well as more conservative bidders remain on the sidelines.

How Houlihan Lokey Can Help

Our firm is extremely well equipped to help our clients navigate uncertain times. We respond quickly to challenging situations and are constantly helping clients to analyse, structure, negotiate, and execute the best possible solutions from both a strategic and a financial perspective.

What We Offer

- Corporate Finance**
- 1 Mergers and Acquisitions
- 2 Capital Markets
- Private Funds Advisory
- Board Advisory Services
- Financial Restructuring**
- Company Advisory
- 3 Distressed M&A
- Liability Management
- Creditor Advisory
- Financial and Valuation Advisory**
- Portfolio Valuation and Fund Advisory
- Transaction Opinions
- Corporate Valuation Advisory Services
- Transaction Advisory Services
- Real Estate Valuation and Advisory
- Dispute Resolution Consulting

Mergers and Acquisitions
 We are widely recognised as a leading M&A advisor to the middle market in general and the packaging and processing machinery sector in particular. Our deep expertise across the sector, knowledge of the strategic landscape, and long-standing relationships with all relevant strategic financial buyers makes us the M&A advisor of choice for strategic transactions in the packaging and processing machinery industry.

Structured Equity Financing
 We have a market-leading private capital markets platform focused on the placement of solution-oriented capital for a wide range of financial needs. We have differentiated investor relationships and access to key decision-makers, allowing us to run a bespoke, high-touch, confidential, and efficient process.

Distressed M&A
 We have the largest, most experienced special situations advisory practice of any investment banking firm and remain a recognised leader in achieving M&A transactions for distressed companies. Our group employs an interdisciplinary approach to engagements and is accustomed to evaluating complex, highly leveraged situations in short time frames.

Why We're Different

- ✓ Deep, Industry-Specific Expertise
- ✓ Strong Relationship With the Most Relevant Buyers
- ✓ Solution-Oriented Capital Markets Platform
- ✓ Dominant in Special Situations and Restructuring
- ✓ Senior-Level Commitment and Dedication
- ✓ Superior Work Product/Technical Abilities
- ✓ Creativity, Imagination, Tenacity, and Positivity

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