Impact of M&A on the Fastener Industry

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The Importance of Southeast Asia in the Current World Economy

Countries in the Association of Southeast Asian Nations (ASEAN) have enjoyed robust growth for more than a decade, marred only by a short-lived blip during the global financial crisis. The current cloudy economic outlook in the United States and Europe will have an impact here, but ASEAN countries are still expected to continue to perform well, supported by high consumer confidence, domestic consumption, urbanization, and growing intra-regional trade.

In accordance with the East Asia Pacific Economic Update released by the World Bank, developing countries in the East Asia Pacific region will continue the stable economic growth this year, bolstered by a recovery in high-income economies and the market's modest response so far to the Federal Reserve's tapering of its quantitative easing.

Developing East Asia will grow by 7.1 percent this year, largely unchanged from 2013, the report says. As a result, East Asia remains the fastest growing region in the world, despite a slowdown from the average growth rate of 8.0 percent from 2009 to 2013. In China, growth will ease slightly, to 7.6 percent this year from 7.7 percent in 2013. Excluding China, the developing countries in the region will grow by 5.0 percent, slightly down from 5.2 percent last year.

The Six Major ASEAN Countries Are Seeing Strong Growth

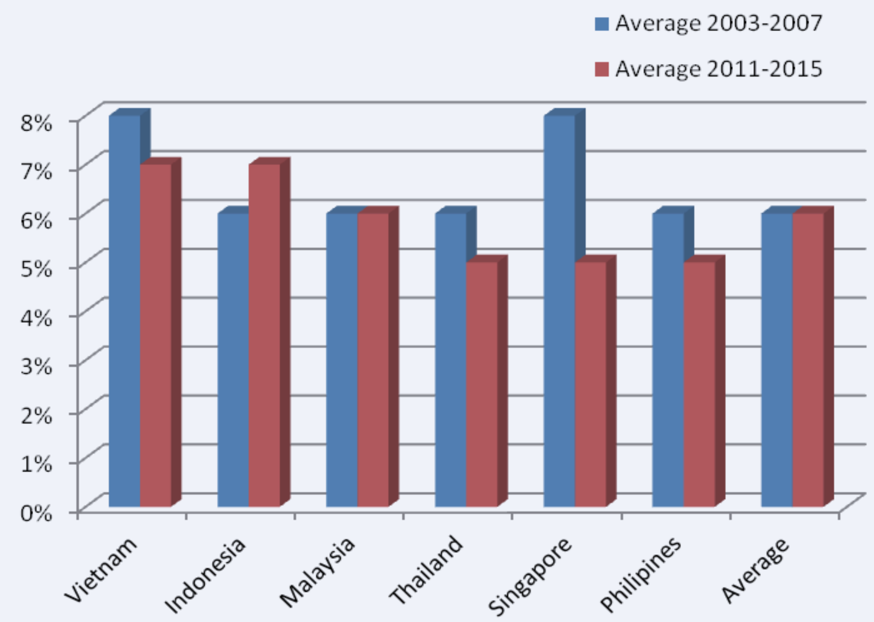
Source: OECD Development Centre's medium-term projection framework in the Southeast Asian Economic 2010.

It's undeniable that Southeast Asia has become a region that multinationals cannot ignore. Although its share in world GDP is still small, it is greater than all of Africa and new powerhouses like India and Russia. If the ASEAN group of countries was a single entity it would be ranked the ninth largest economy in the world.

Mergers and Acquisitions (M&As) in This Region

The Asian market is heating up, and both local and international firms are looking to get in on the mergers and acquisitions (M&As) that are poised to play a pivotal role in the restructuring of all manner of industries.

Southeast Asian companies are positioned to carve out a place as regional champions. ASEAN is home to a diverse



set of consumer markets with a wide range of income levels. The variety of ethnicities, languages, and cultures impacts consumer tastes and preferences. Southeast Asian companies with strong consumer insight have an edge in ASEAN's segmented markets.

Asia is home to diverse and fragmented markets. Fragmented markets will give rise to a series of sub-segments at different price points within each market. Asia's fragmented markets will create opportunities for several clusters of local players to dominate specific sub-segments of an industry; for instance, industrial manufacturing, retails, banking, financial, and telecom. The existence of two or three global companies that dominate an entire industry, which is common in Western markets, is unlikely to emerge in this region. Local companies and manufacturers which leverage strong local understanding to win in the market and gain increasingly better access to capital and resources to acquire competitors, will have an edge. Industries, in the meantime, will not be dominated by an optimum number of large companies. Consolidation will play out along these segmented lines, giving rise to local champions that dominate different price points or subcategories. Southeast Asian companies that start planning now can make tactical moves that will put them ahead of the curve before the industry matures.

It is notable that M&A is a risky business, particularly in this region. Studies done by A.T. Kearney indicate that only 29 percent of companies worldwide see an increase in aggregate profitability while 57 percent see a decline after an M&A event. That figure drops even lower in Asia which is only 24 percent of Southeast Asian mergers delivering the expected benefits. The risk increases as companies venture across borders. Cross-border M&As are hard to pull off because of a host of factors, including culture clashes, poor communication, and lack of local market know-how. Reaping the full benefits of M&A will require a plan for how to do it better. Many companies go into M&A without any preparation, resulting in poor deals or expensive and chaotic acquisitions. Thus, mergers and acquisition does not guarantee success.

M&As in Fastener Industry

Most of the largest and most successful fastener manufacturers have used merger and acquisitions to fuel growth and gain economies of scale while maintaining, or even improving, gross profit and operating margins. Fields Fasteners and HRS Logistics merger is one of the good examples of successful strategic partnership. Great synergy between two companies, similar cultures that place a high value on the team, customers, and suppliers, all creating the opportunity of expanding the products and services offered to their customers and the ability to provide more technical services to drive short and long term cost savings.

Technology and quality control systems embraced by the fastener manufacturing and distribution industry have created large barriers to entry for new start-up companies. However, the cost of advancements in technology and quality systems has also made it difficult for small and middle market distributors to keep up. Because of the increasing costs of technology and operations necessary to provide value to customers in the fastener industry, many fastener distributors and manufacturers are facing difficult growth challenges. At the same time, the value of their company may be at its highest. There are a substantial number of strategic and financial buyers in the market ready to acquire quality fastener distributors. LIC Nomura in India, the MF arm of the nation's largest financial entity, may look at inorganic growth route to emerge as a major player in the cluttered industry that has been bleeding for years due to falling margins and flight of investors. Although they are one of the key players in the financial industry, they are looking for diversification to expand and grow their businesses. Another example is Fontana Group., a diversified group of companies, which recently acquired Acument Global Technologies Inc., the leader in providing manufacturing fastener solutions for the markets of the United States, Mexico and South America. Another example is the acquisition of the Unisteel Technology Group in Asia, by SFS Group, a manufacturer of fasteners for electronic devices, providing the company with a further strong base in new growth markets and growth sectors.

The competition for quality fasteners, along with the availability and low cost of capital has driven valuations up substantially; but, such higher valuations are justifiable for acquirers given current economic conditions and the necessity to grow beyond the fastener demand. As a result, many owners of fastener companies will take advantage of these unique industry conditions and exit their companies with premium valuations. Therefore, acquisition activity in the fastener distribution industry will likely remain very strong.

Interestingly, a noticeable rise of cross-border M&A from Asian countries over the past decade has coincided with a substantial improvement in financial markets in the region. For instance, Shanghai Prime Machinery, a Hong Kong listed and China-based Company headquartered in Shanghai, acquired Koninklijke Nedschroef Holding B.V, which is a China-based company that is headquartered in Helmond, Noord-Brabant. The target is engaged in the development, manufacture, and supplies of fasteners and special parts for the automotive industry. This is especially important for the fastener companies seeking long-term strategic positioning of their group. Another example of cross border M&A is the acquisition of Hi-Performance Fastening Systems (HQ in Bensenville) by MW Industries Inc., a leading provider of highly engineered springs, which could significantly assist MW for better positioning to penetrate their existing market.

Conclusion

Over the longer term, structural reform can increase developing Eastern Asia's underlying growth potential and enhance market confidence. China has already begun a series of structural reforms in finance, market access, labour mobility and fiscal policy to increase efficiency of growth and boost domestic demand. These reforms are part of an overall package of initiatives aimed directly at increasing economic productivity and sustaining growth across the whole economy. For example, the government recently announced detailed rules for the China (Shanghai) Pilot Free Trade Zone (FTZ) which aims to further open up investment in selected services activities. In the energy market, it has announced significant economic incentives for renewable technologies. Moreover, building a business case for investment in new green technologies and infrastructure requires targeted policies. Accordingly, the interest of Asian countries such as India, Maldives, and Sri Lanka to join the Maritime Silk Road project could be one of the clear results of the recent structural reforms by China.

As mentioned earlier mergers and acquisitions in the fastener industry have been made and action has been taken to enhance productivity as major optimization. The strategic partnership could enhance both positions in the marketplace by expanding the products, services, and geographical footprint in which manufacturers service their customers. The combined companies could provide greater opportunities for entities, increased capabilities for their customers, and a larger spending with their strategic suppliers.

Successful M&As in the fastener industry could provide opportunity for manufacturers and distributors to expand their products and services offered to the customers and the ability to deliver more technical services to drive short and long term cost savings. ■

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