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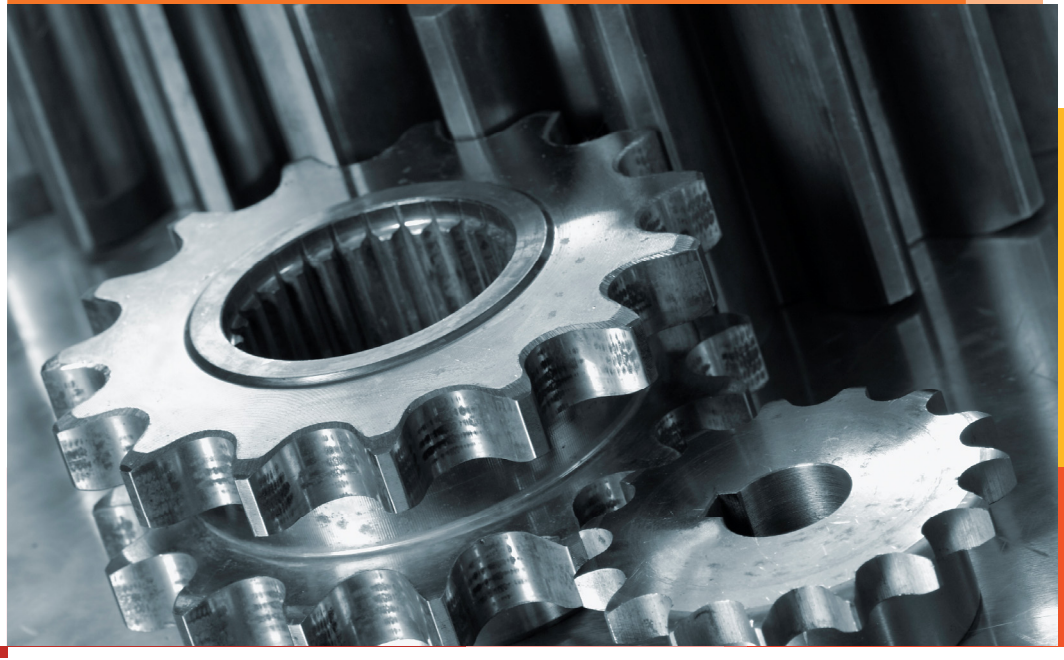
Doing deals in 2013

An insight into current industrial products deal environment



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Introduction

Dear reader,

Despite the fast catch-up from the economic downturn in 2009 across the industrial products (IP) sector, the past years have been very challenging for the German transaction activities within this sector. In order to understand the key drivers of the current deals market we conducted the following Point of View to assess the current economic climate and outlook for 2013 and to reflect on the deals environment and its characteristics.

For the upcoming years, we see a stable economic development for the German market, supported by the continuously stable demand from non-EU markets e.g. the US and China. The positive forecast for the economic growth of BRIC countries strengthens this expectation.

As the IP sector provides sufficient profitability, shows enough room for consolidation and still provides a high level of innovation we predict an ongoing stable level of transactions. However, the average deal values within the IP sector are slightly decreasing.

The Deals in the German IP sector are primarily driven by corporates. These, in particular have increased their cash position during the last years which eases access to liquidity for further acquisition activities.

We assume an increasing number of Private Equity deals in the next two years due to portfolio companies reaching the upper limit of its holding duration as well as enough liquidity for leveraged buy-outs being available in the market.

Furthermore the increasing level of cross-border deals on German IP deals shows the importance and attractiveness of German targets.

Based on our analysis and the above mentioned topics we believe that the German industrial production market is a highly attractive investment area and remains attractive for the next years.

We wish you an interesting reading and looking forward to meet you in upcoming deals.

Kind regards,

Christian Knechtel

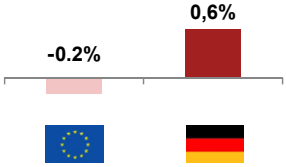
"Despite economic uncertainties we expect significant deal activity within 2013 and 2014"

Christian Knechtel, Deals Leader Industrial Products, PwC Germany

Key take-aways

1 Stable development of German economy in 2013

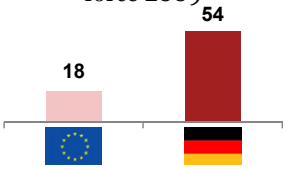
GDP YoY growth 2012/13



- Stable market conditions in Europe and Germany
- Positive outlook for the market segment industrial products (IP)
- Major driver is still the solid export to the fast growing economies

2 IP sector is highly attractive for deals

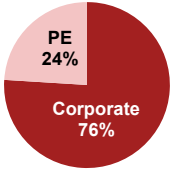
Patents/1 million labour force 2009



- German IP sector highly attractive due to various consolidation opportunities, its high level of innovation and profitability
- Most attractive sectors are manufacturing of machinery and fabricated metal products

3 Deals in IP sector are mainly driven by corporates

Deals in German IP 2012



- Overall cash position puts German corporates in the position to drive deals in the coming years
- Positive outlook for Private Equity driven LBO market in 2013 due to the need for exits and positive liquidity outlook

4 Increasing importance of cross-border deals in German IP

Foreign Investments 2012

- Increasing share of the FDI stream from North America and BRIC countries (especially China)
- US with continuous importance, China with strong appetite to invest in the German IP sector

Table of Contents

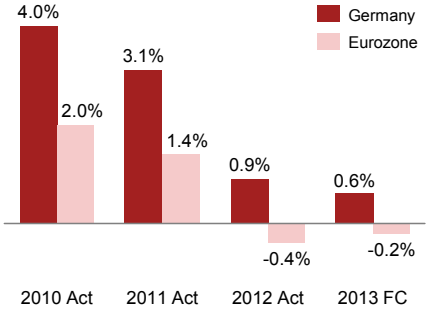
Section	Overview	Page
1.	Stable development of German economy in 2013	9
2.	IP sector is highly attractive for deals	19
3.	Deals in IP sector are mainly driven by corporates	29
4.	Increasing importance of cross-border deals in German IP	41
Appendices		
1.	About the authors	49
2.	Contact persons	53

Stable development of German economy in 2013

1

The economic development in Germany remains stable

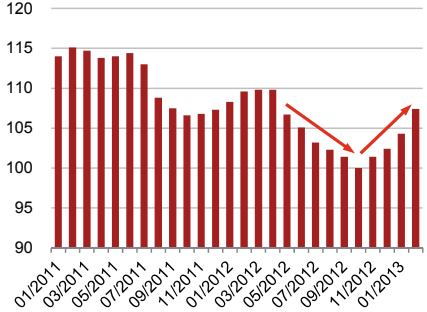
YoY GDP growth 2010 - 2013



Source: IMF, 01/2013

- **GDP growth** in Germany expected for 2013 slightly below 2012 level (~ 0.6% growth p.a.)
- **German economy** expected to perform above **European average**
- **Europe trend** in 2013 improving but still negative

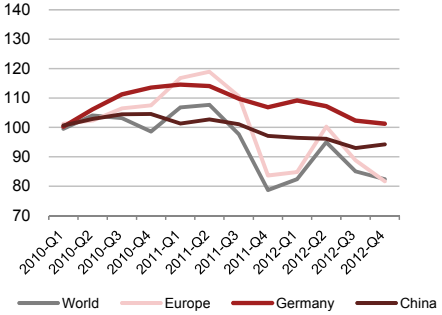
Business climate Germany 2011 - 2012



Source: ifo-Institute, 03/2013

- Hints of a **trend reversal** at year end 2012 after six declining months
- ***"Business with positive outlook for 2013 with increasing growth impulses mainly from China"***
  CSO, manufacturer of hydraulics equipment

Business climate International regions 2010 - 2012

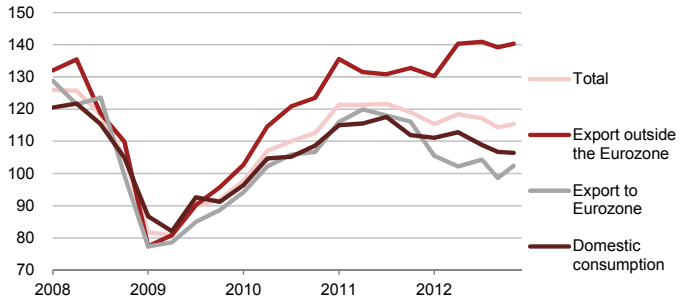


Source: CesIFO 12/2012

- Similar development of the **business climate in other regions**
- **World and European** economies **much more volatile** than Germany and China
- Since Q3 2012 **stabilisation of the Chinese** business climate

Soft landing of IP industry in 2012 due to stable demand from non-EU markets

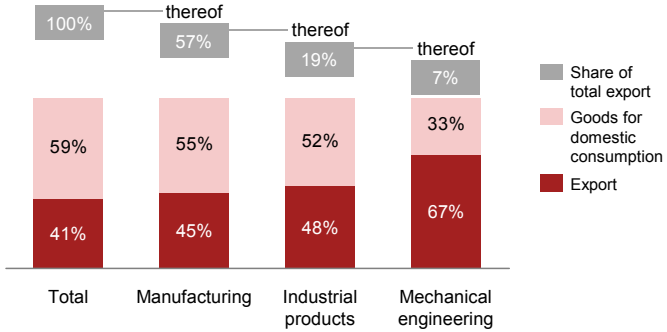
Order index within German manufacturing sector 2008 - 2012



Note: Index value 2005 = 100
Source: Statistisches Bundesamt, 01/2013

- Rising and resilient **demand from non-EU markets cushions the slump** of European economies
- ***"The German industry held its production level in Q3 2012 on the same level as in the previous year. (...) Once again the driving forces behind this were the traditionally strong mechanical engineering and automotive industries, which benefit from a high demand from non-EU markets."***
  Source: DIW Wochenbericht, 28.11.2012

German export ratio for selected sectors Status 2011

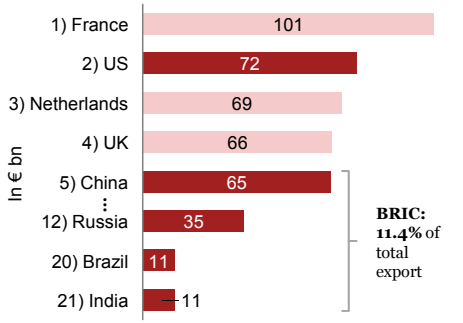


Source: Statistisches Bundesamt and Statista, 11/2012

- Well **balanced export and domestic** share (45% to 55%) within German manufacturing industry
- **Manufacturing sector** is responsible for almost 60% of the total German export (mostly due to industrial products and automotive exports)
- Especially within the **mechanical engineering** sector the export ratio (67%) is far above German average (41%)

BRIC's ongoing economic growth as major driving force for German GDP development

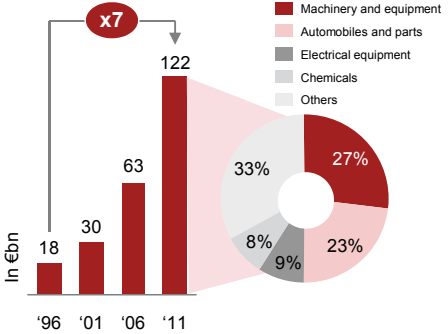
Trading partners of Germany – Status 2011



Source: Statistisches Bundesamt

- **US and China** are Germany's most important trading partners outside Europe
- Importance of Russia, Brazil and India as trading partners of Germany has been **rapidly increasing** in the past decade

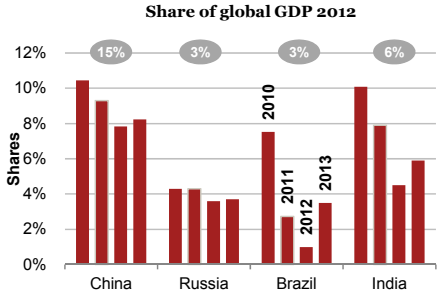
German export to BRIC 1996 - 2011



Source: Statistisches Bundesamt

- ***"The next decade will power the BRIC economies to be bigger than the US and determine most Western multi-nationals' global success or failure."***
  Source: Jim O'Neill, Goldman Sachs, Originator of the term "BRIC", 19.11.2011

GDP growth across BRIC 2010 - 2013

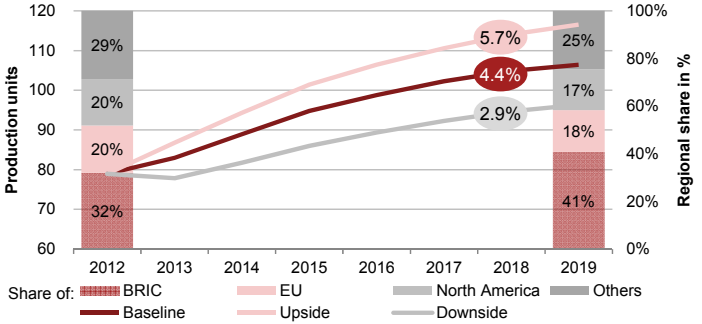


Source: IMF World Economic Outlook Jan 2013

- **China** is the **driving force** of worldwide economy with continuously high growth
- In 2013 all BRIC countries are expected to recover from economic slowdown in 2011/2012, which will further **increase demand for German industrial products**

Increasing share of BRIC automotive production will further trigger investments in industrial products

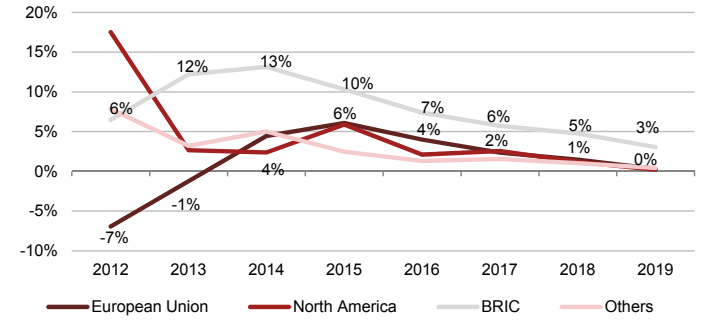
Automotive production shift to BRIC 2012 - 2019



Source: PwC Autofacts, 01/2013

- **Automotive** sector is a **global economic driving force** with a **CAGR of 4.4%** from 2012 to 2019
- The **IP sector as supplying industry** is going to benefit from the ongoing growth in the Automotive sector
- New technologies, i.e. **electro mobility,** show growth rates of **32% p.a.** (2012 - 19) but contribute to only 1% of projected global volume in 2019

Automotive markets YoY growth rates 2012 - 2019



Source: PwC Autofacts, 01/2013

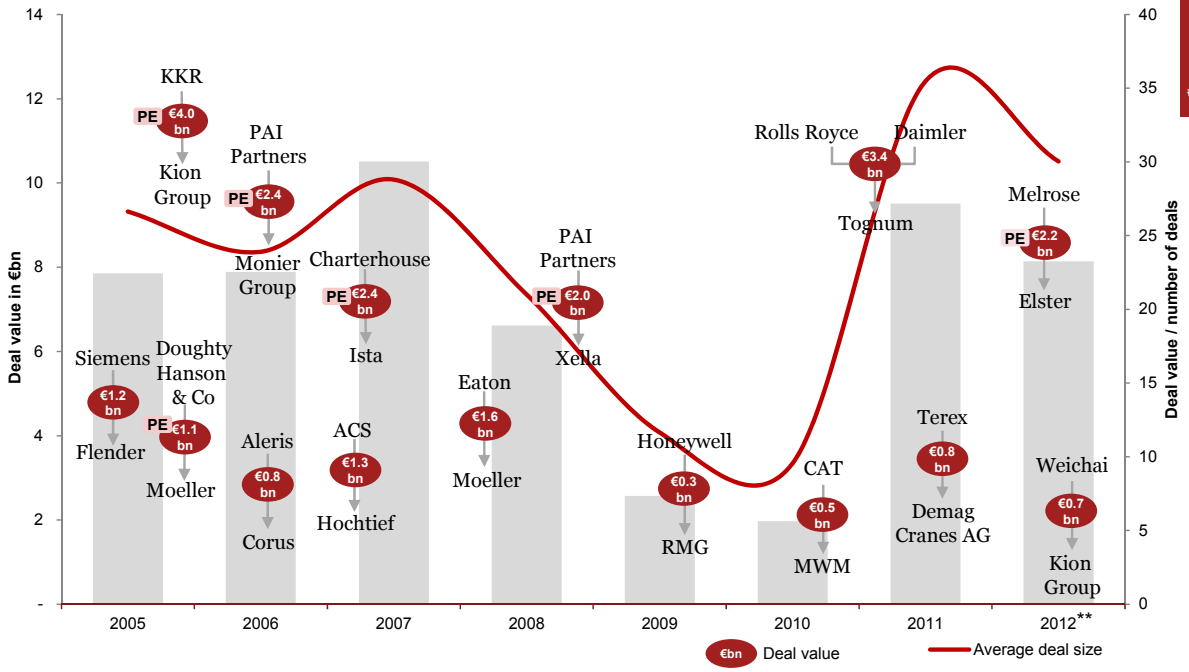
- While German car production only shows **minor** or even negative **growth rates**, production in BRIC increases **above 10% p. a.** within the next three years
- ***"Production shifts trigger plant manufacturing and mechanical engineering orders, but impact decreases over time as average growth of BRIC's car production is falling"***
  Jan Maser, PwC Autofacts

IP sector is highly attractive for deals

2

Level of IP deals in 2011/2012 back on pre-crisis level – the average deal value is decreasing

Deal value industrial products in Germany 2005 - 2012



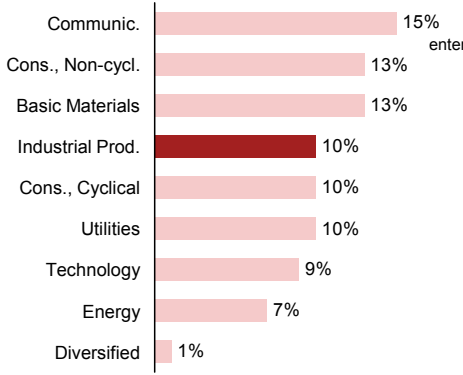
Average value per deal*
FY05-08 vs. FY09-12:
€267m **28%** *€191m*

- After slowdown during the financial crisis **increasing deal activity** in the **past two years** can be observed
- **Average deal size** decreasing since 2007
- Multimillion big bets until **2008** were **driven by PE**, in 2012 PE houses started to become more active again

Source: Merger Market and Thomson Financial, 02/2013 *Average deal value only for deals with a disclosed deal value **In 2012, some announcements might still pending

German IP sector is attractive for deals due to its profitability, fragmented industry landscape and high innovation level

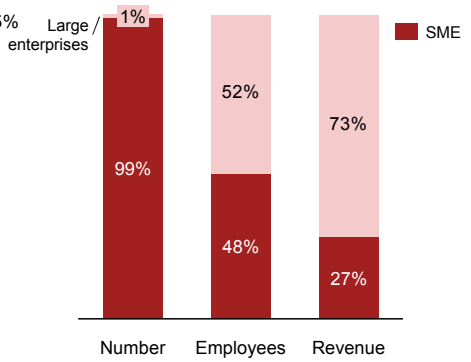
Industry EBITDA margins Status 2012



Note: Top 500 listed German companies
Source: Bloomberg, 12/2012

- With an **EBITDA margin of 10%** the industrial products sector is among the more **profitable** industries in Germany

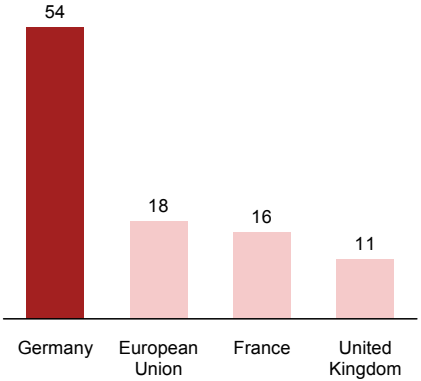
IP industry fragmentation Status 2009



SME (Small and medium-sized enterprises)
<250 employees/<€50m revenue/<€43m total assets
Source: ifm, Statistisches Bundesamt

- 1% of all companies contribute **73% of revenue** within the German IP sector
- Highly **heterogeneous IP landscape** of SMEs reveals further consolidation potential

IP patent applications Status 2009*

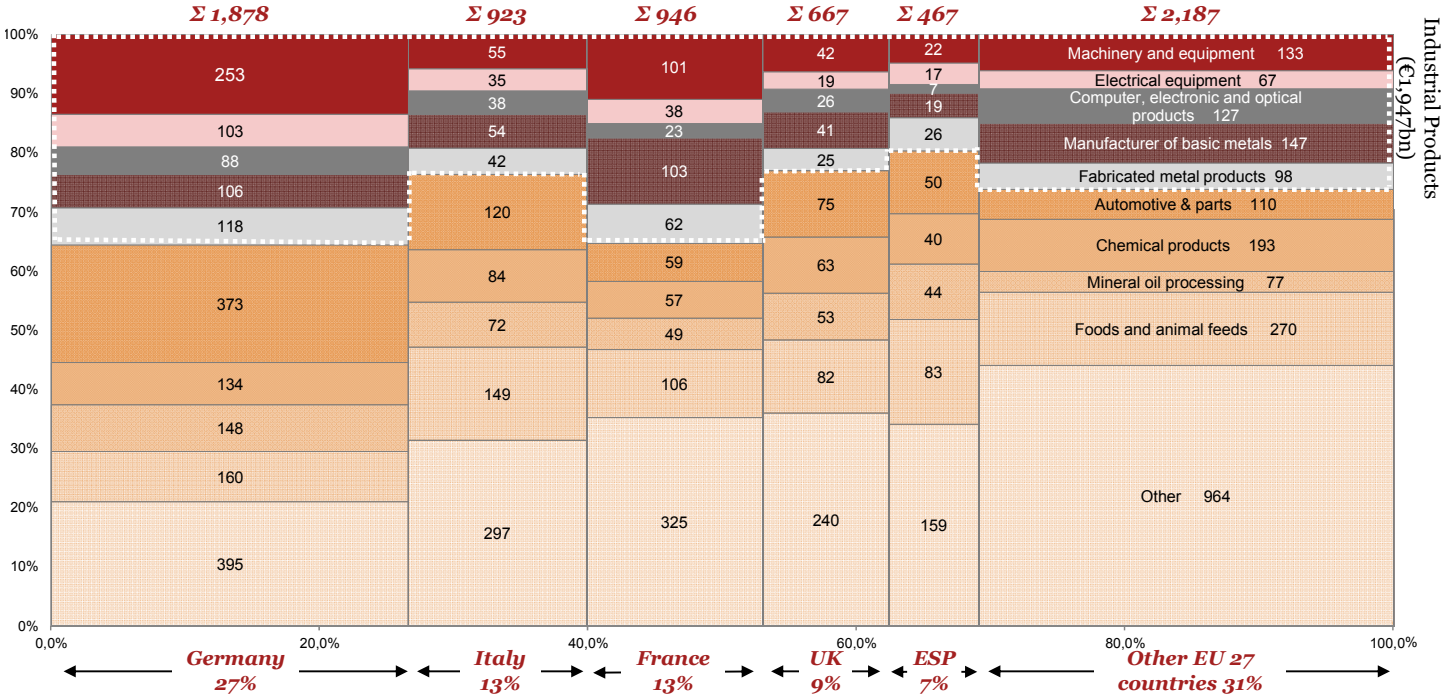


* Patents per million labour force
Source: Eurostat, 2009

- Germany is by far leading in **granted patents and patent applications** per labour force in Europe
- **Knowledge and technology transfer** are important deal drivers, in particular for inbound deals

Germany contributes additional 34% to the EU27 area industrial products sector in 2011 with total revenues of €1,947bn

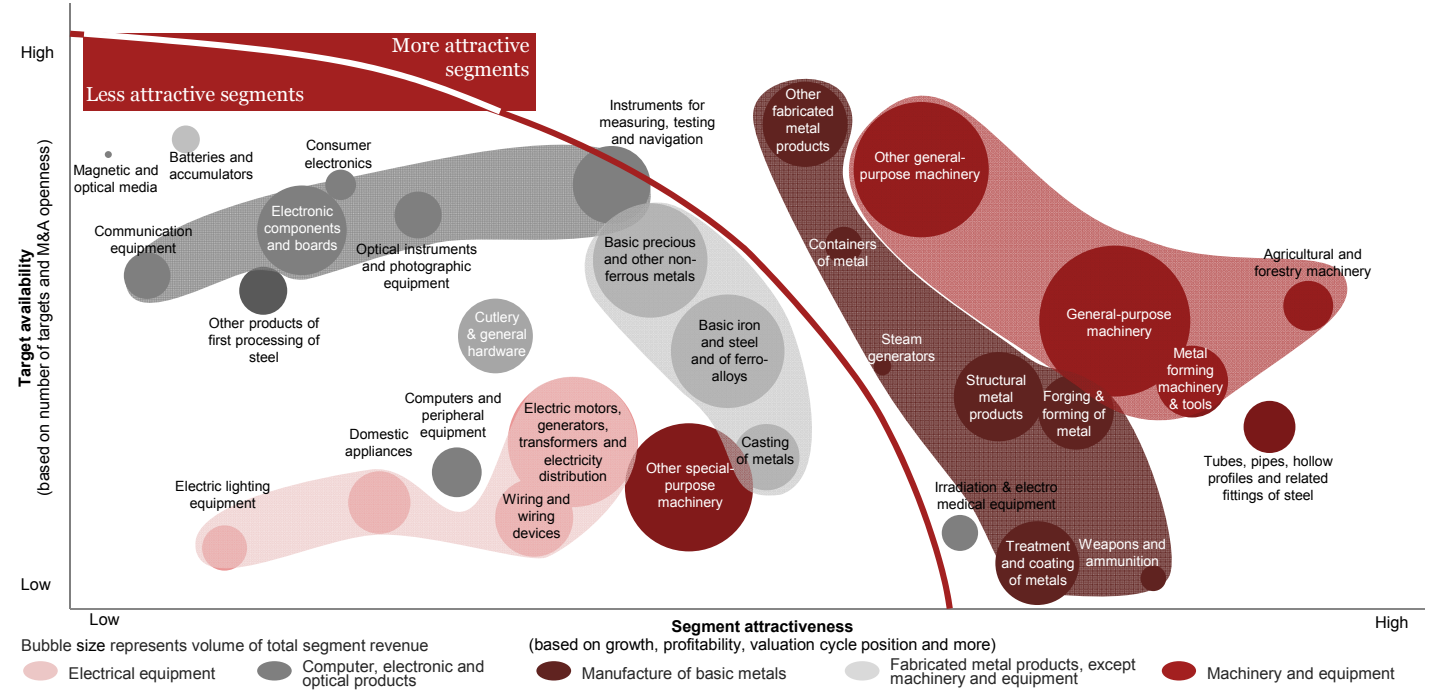
European Processing Industry with total revenues of €7,068bn in 2011



Source: Eurostat 02/2013

Manufacturer of basic metals and manufacturing of machinery and equipment as most promising segments for future deal activities

Segment attractiveness and target availability within the industrial products sector



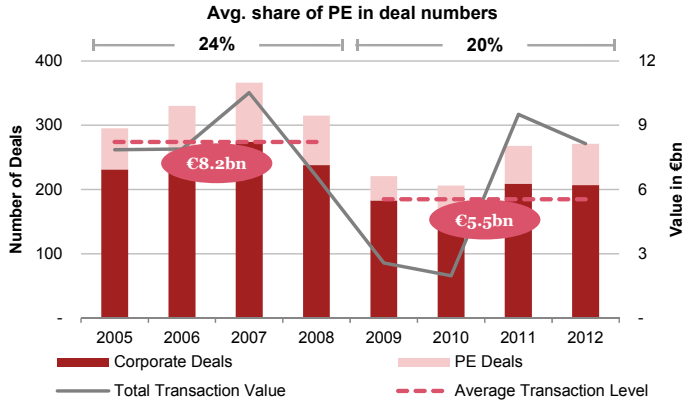
Source: Statistisches Bundesamt, 2011 (latest release)

Deals in IP sector are mainly driven by corporates

3

Within the IP sector the importance of private equity is decreasing compared to corporate-driven deals

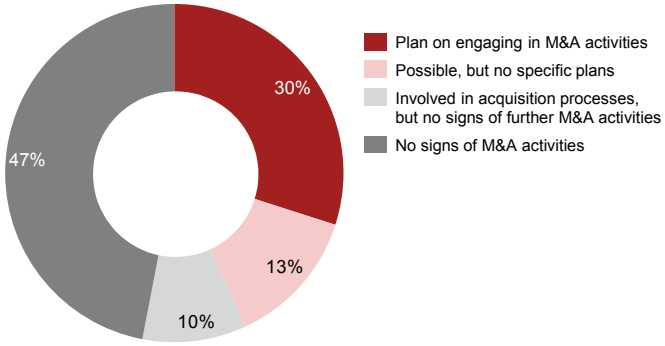
Total Deals in German IP sector 2005 - 2012



Source: Thomson Financial, 02/2013

- Average **number of annual deals** has stabilised in 2011/2012 at above 200, total transaction value 2012 has reached pre-crisis level in 2011
- Post crisis **average transaction level of** €5.5bn (2009 to 2012) is **33% lower** than the €8.2bn before (2005 to 2008)
- Since 2009 the **share of PE deals in total number of deals is declining** from 24% (2005-2008) to 20% (2009-2012)

M&A indication of DAX-30 companies in 2013

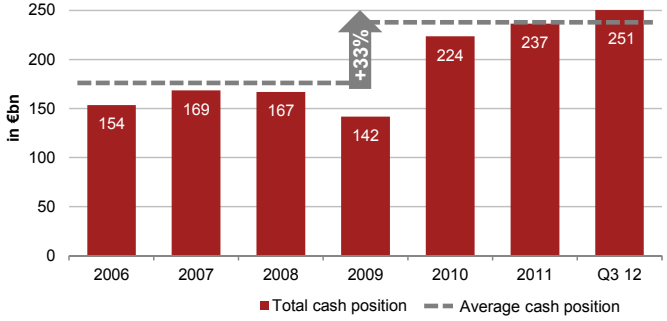


Source: PwC Analysis, Merger Market, Factiva News research 10/2012

- Around **50% of DAX companies** plan further M&A activities or are currently involved in M&A activities

33% higher cash position of listed German corporates; Since Q2 2012 negative trend in absolute number of carve-outs

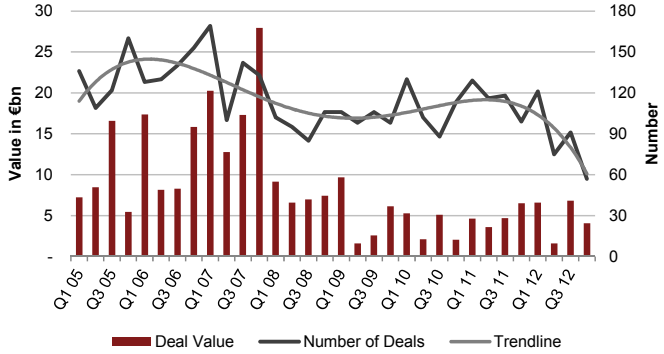
Cash positions of listed German corporates 2006 - 2012



Note: 140 companies listed in DAX, MDAX, SDAX and TecDAX
Source: Standard & Poor's Capital IQ, 01/2013

- **Positive trend** regarding **cash** position of German companies after financial crisis provides backup for upcoming crisis and opportunities for anorganic growth

Divestments with German targets 2005 - 2012

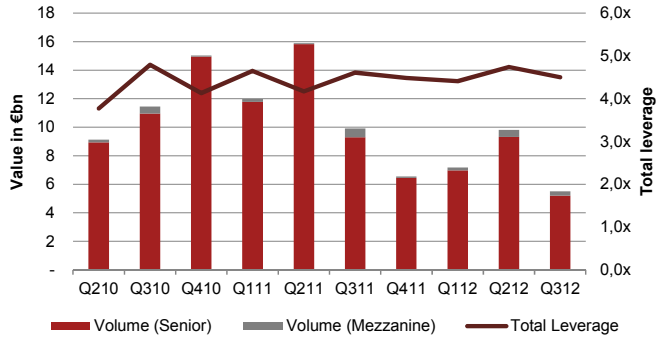


Source: Thomson Financial, 12/2012

- **Average number of carve-outs** pre-crisis (2005 - 2008) **decreased** by 15% for the period thereafter
- Since Q2 2012 **negative trend in absolute number of carve-outs** as the stripping of the "Deutschland AG" is coming to an end

Purchase price multiples have continued to creep up throughout 2012, while leveraged debt multiples remained rather constant at 4.5x

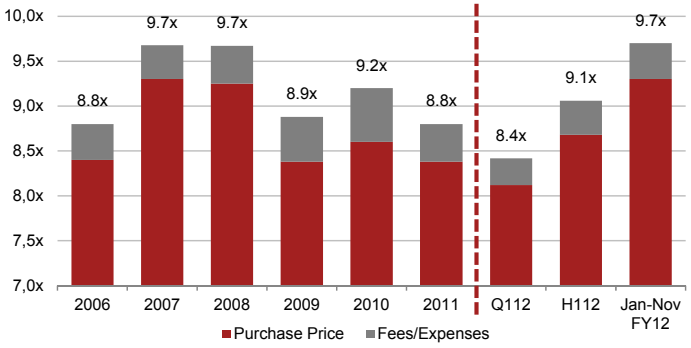
European leveraged loan volume and total leverage



Source: Standard & Poor's LCD, 2012

- European leveraged loan volumes were significantly depressed at €28.5bn in 2012, 34% down from 2011
- The **total leverage** remains on average at **c.4.5 x EBITDA**
- ***"Financial markets will remain volatile for the foreseeable future and rather be driven by technicals than fundamentals. The trend of bond-for-loan transactions is likely to continue, especially as CLO volume dries up in 2013"***
  Daniel Judenhahn, PwC Debt & Capital Advisory

Purchase price multiple

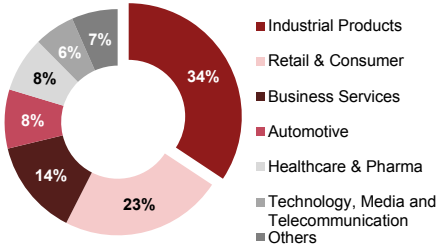


Source: Preqin, Standard & Poor's LCD, PwC analysis, 2012

- Over the past years, **purchase price multiples** have remained rather **stable** (Ø 9.2x EBITDA); not least due to the amount of uninvested fund capital chasing fewer deals
- In **2012 purchase price** multiples have **steadily increased** (i) as more defensive sectors are targeted and (ii) due to a smaller deal sample size; in Germany multiples increased from 8.8x (2011) to 9.7x (Nov 2012)

Major stimulus for PE deals is expected from exits of existing portfolios; further reduction of liquidity for PE funds anticipated

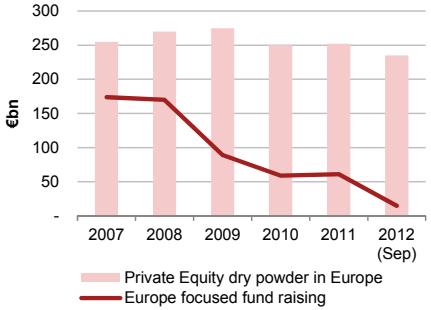
Composition of Private Equity funds in 2012



Source: Merger Market, 12/2012

- IP industry as **most attractive industry** for Private Equity with 34% of investments

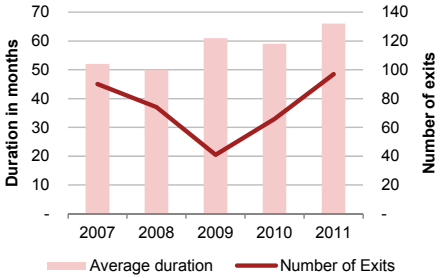
Unspent vs. Raised funds in Europe 2007 - 2012



Source: Preqin, 10/2012

- Significant amounts of **uninvested capital exists** and need to be:
  - **Invested** or
  - **Paid back** to the stakeholder at the end of the run-time

Holding durations of port-folio companies 2005 - 2011



Source: Thomson Financial, 08/2012

- Average holding duration of **4.8 years**, slightly above pre-crisis level
- Many deals completed in 2007/2008 with **postponed exits** due to economic uncertainties
- **Pressure** to divest increases as funds reach the end of their investment periods

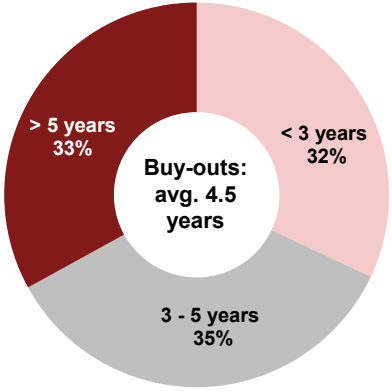
PE portfolios mainly sold to strategic investors; current portfolio age structure promises upcoming divestment activity

Global PE exits by type 2005 - 2011

Source: Deallogic 2012

- **Majority of** Private Equity investors chose **strategic sale** to exit portfolio companies

PE portfolio inventory by age classes in Germany



Source: BvK Study, 2012

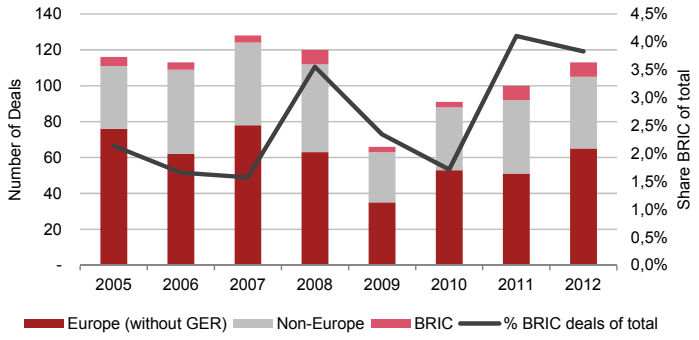
- 1/3 of all portfolio companies are **already above 5 years** of its holding period – divestment in near future is likely

Increasing importance of cross-border deals in German IP

4

Doubled share of BRIC's in cross-border deals with German targets; Foreign direct investment mainly in Manufacturing sector

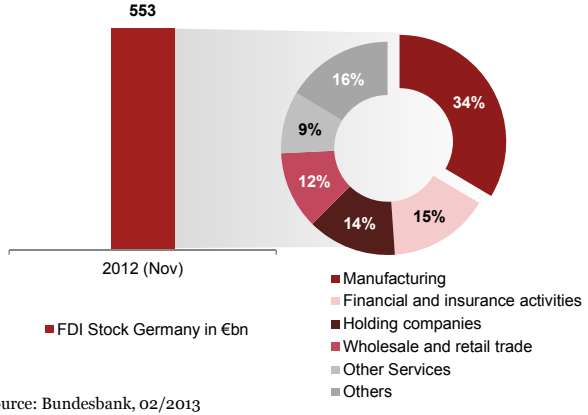
Cross-border deals with German IP targets 2005 - 2012



Source: Merger Market, 09/2012

- **Cross-border deals from financial crisis**, mainly stimulated by US and BRIC
- **BRIC countries** have **doubled** their share in 2011/2012 (from 4% avg. in 2009/10 to 8% avg. in 2011/12)
- **United States** by far **biggest investor in German IP market** outside of Europe concerning cross-border deals

FDI stock Germany 2012

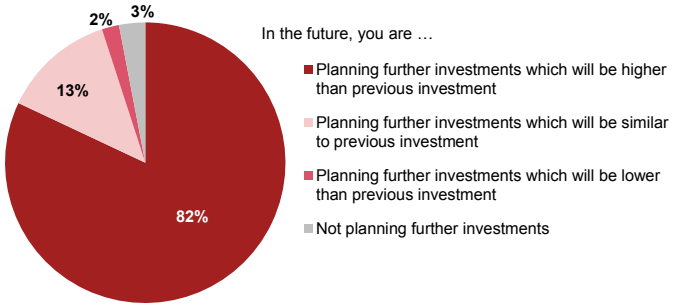


Source: Bundesbank, 02/2013

- Manufacturing and thereby **IP sector** is **preferred target industry** for increasing FDIs in Germany
- German **FDI stock** increased since 2005 (€403bn) to €553bn
- German **manufacturing sector** holds largest stock of direct and indirect FDIs (34%) followed by financial services

Chinese enterprises plan to invest further and by larger transactions in the EU while there are still non-regulatory obstacles to handle

Chinese enterprises' future EU investment plans



Source: Chinese Outbound Investment in the European Union, 01/2013

- **97% stated that they plan to invest further**, with the vast majority planning investments of a higher amount
- Indicators are that Chinese enterprises will expand existing investments and **invest more and at larger amounts** in the future

Non-regulatory obstacles when investing in the EU

Source: Chinese Outbound Investment in the European Union, 01/2013

- A number of **obstacles** are **related to HR issues** (incl. cultural differences, obtaining visas, work permits etc.)
- The **currency risk does not include Germany but** mainly the Netherlands, France, Italy, Belgium etc.
- A **lack of internationally experienced Chinese** talents was noted, which is not an EU-specific issues

Recent M&A activities with Chinese investors in Germany were driven by access to technology, customer base and resources

Major deals and underlying rationale with Chinese investors

Major deals

- **KION Group**, €738m, Aug. 2012
- **Schwing** GmbH, €380m, Apr. 2012
- **Putzmeister** Holding GmbH, €357m, Jan. 2012
- **ThyssenKrupp Tailored Blanks**, €260m, 2012
- **KSM Castings** GmbH, €380m, July 2011
- **ATB Austria Antriebstechnik** AG, €100m, 2011

Key rationale

1. **Access to technologies, know how and patents**
   "From now on it is a matter of acquiring advanced foreign technologies and established foreign brands."
2. **Access to the market**
   "Chinese investors (...) want to use the products of acquisition candidates to enter the Asian market."
3. **Access to resources**
   "Particularly the Chinese five-year plan aims to develop international energy resources."
4. **Anorganic growth**
   "In the Chinese 5y plan companies are encouraged to seize upcoming foreign investment opportunities."

Case Study: China's Wolong buys ATB Group for $138m

Deal rationale

- Use prestige and brand of ATB to establish as **globally leading motor manufacturer**
- Use existing technology and expertise of target to **focus on R&D** and **purchasing**
- Additionally acquiring firms in the US **focussing** on **sales**

Lessons learned

- Identify **key decision maker** (Chairman or party official)
- Establish a **personal relationship** of mutual trust
- **Lobbying** to ensure a smooth transaction (official approvals and bank loans)
- **Access to debt** not important, all outbound deals in Europe financed by Chinese banks so far
- **Top management** often Chinese speaking
- Establish **Chinese/German team** on advisor side to ensure personal and timely communication

"Give us five years and ATB will become number one of its branch."
Jiancheng Chen, Chairman of Wolong Holding

Appendix 1

About the authors

Christian Knechtel

Partner
Industry Leader Transactions

Experience Summary

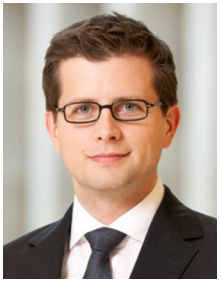
Christian Knechtel has over 17 years functional industry and consulting expertise gained with deals in the automotive and mechanical engineering sector.

Joachim Hogg

Senior Manager
Management Consulting

Experience Summary

Joachim Hogg has over 7 years industry and transaction expertise gained in various IP segments with focus on construction machinery, material handling equipment, mechanical engineering and automotive supplier.



Marc Niemeyer

Manager
Management Consulting

Experience Summary

Marc Niemeyer has gained over 6 years of cross-functional experience in industrial as well as consulting deals mainly focused on industrial manufacturing and automotive industry.

Appendix 2

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