INTEROCEAN
*Investment Bank for the Manufacturing Sector* SM

# Quarterly Manufacturing Update

## Q3 2018


InterOcean Advisors LLC
225 West Washington Street
Suite 1400
Chicago, IL 60606

www.ioadvisors.com

## Introduction

InterOcean (IOA) closely follows economic and M&A transaction activity in the manufacturing sector. Each quarter we issue a market overview that offers our perspectives on the state of the manufacturing sector and provides insights into select end market industry verticals that we cover.

# Leading Economic Indicators

## Tariff Uncertainty

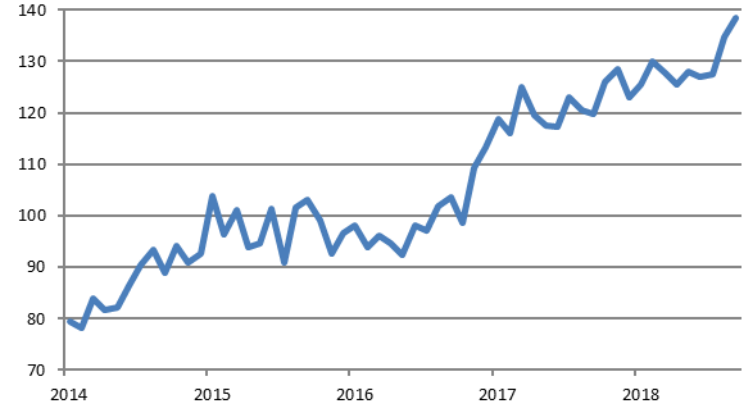
The U.S. manufacturing sector again sharply underperformed the overall equity markets in Q3 2018. Uncertainty over additional rounds of tariffs, the strong U.S. dollar and increasing costs of raw materials is impacting growth and corporate earnings. Manufacturers have had mixed success passing on higher metal costs to their customers. For those companies that have had some success passing on increased costs, the downstream consumers are likely to soon experience inflationary pressures.

The tariffs on steel and aluminum, and the broader round of tariffs imposed April 3rd on over 1,300 products, have complicated the assessment of value for mergers and acquisitions. Cash flow of metal-consuming companies has declined – often resulting in lower shareholder value and reluctance to sell at reduced purchase prices. It appears that the latest round of tariffs has – at least temporarily - inflated earnings and related values of protected companies, causing buyers to balk at offering higher values for companies with potentially unsustainable cash flows.

The U.S. PMI remained high at 59.8 at the end of September – even as the Eurozone and China PMIs demonstrated declining confidence in the manufacturing sector. U.S. consumer confidence remains elevated while consumers have yet to be confronted by expected widespread rising prices. Increasing housing prices have begun to negatively impact new home sales.

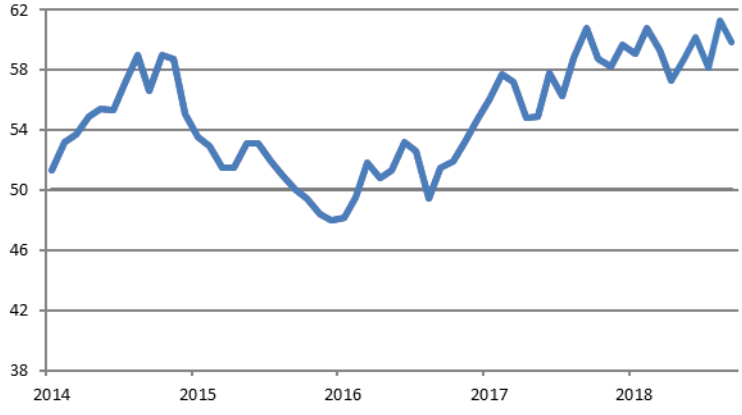
We expect continued stock price softness in the manufacturing sector until the trade war with China is resolved.

**Chart 1: Consumer Confidence Index**



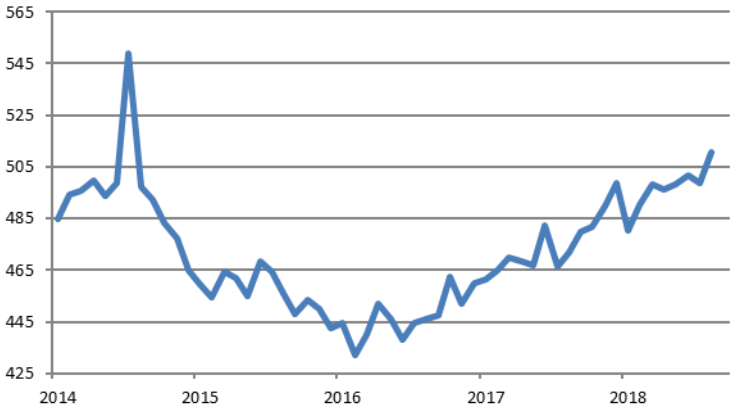

*Source: The Conference Board*

**Chart 2: Purchasing Managers' Index (PMI)**



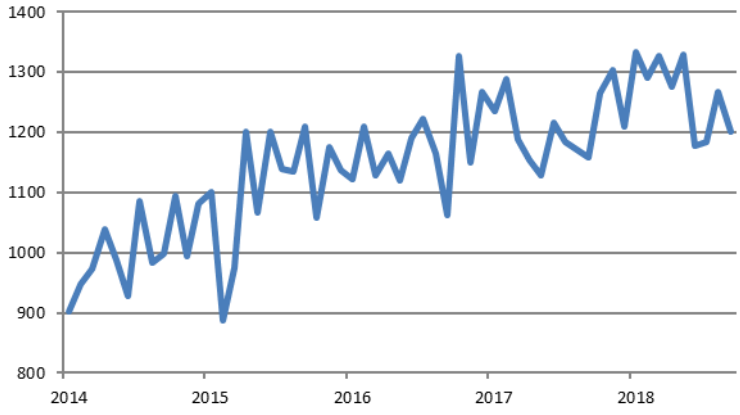

*Source: Institute for Supply Management (ISM)*

**Chart 3: Manufacturers' New Orders ($ in billions)**




*Source: U.S. Census Bureau*

**Chart 4: Housing Starts (thousands)**




*Source: U.S. Census Bureau*

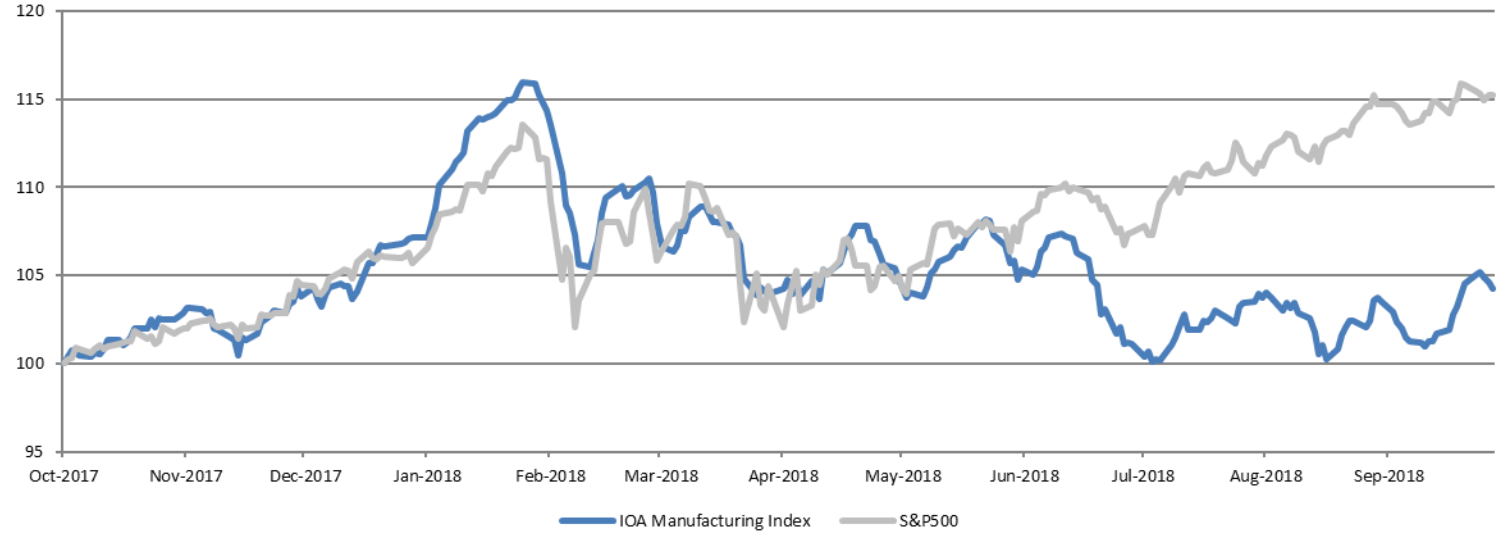
** New privately owned housing units started at a seasonally adjusted annual rate*

# Manufacturing Sector Performance

## InterOcean Manufacturing Indices

The InterOcean Manufacturing Index provides a snapshot of the market performance of publicly traded manufacturing companies. The Index equally weights our industry-specific indices, so as not to skew performance toward any single industry covered by InterOcean. Each industry-specific index is comprised of a representative group of 25-35 publicly traded manufacturing companies that are important participants in that market. The indices measure the movement in the aggregate stock prices of the individual companies in each index over the past year and are calculated by market capitalization weights for each stock in the respective index. The S&P500 is a market value-weighted index of 505 publicly-traded stocks issued by 500 large companies with market capitalizations of at least $6.1 billion across multiple industries. Each quarter, InterOcean resets the indices to 100. Neither the InterOcean Manufacturing Index nor the industry-specific indices are securities. As such, no direct investment can be made in these indices. Past performance is not a guarantee of future results.

**Chart 5: InterOcean Manufacturing Index vs. S&P500**




*Source: S&P Capital IQ and InterOcean Advisors; data as of September 30, 2018*

## Highlights of Q3 Index Data

- InterOcean Manufacturing Index increased 3% in Q3 2018, underperforming the broader market. The Automotive Index demonstrated the largest decrease (-9.1%), while the Aerospace & Defense Index had the largest increase (12.8%). The stock prices of many companies in the InterOcean Manufacturing Index have fallen sharply during the recent sell-off in October.
- IOA Automotive Index performance reflected decreased cash flow resulting from tariffs imposed on steel and aluminum in Q2 2018 and from the threat of additional tariffs on imported vehicles and parts. The LTM EBITDA valuation multiple declined 1.7x (see page 6), reflecting concerns that vehicle sales may be influenced by higher prices.
- IOA Aerospace & Defense Index outperformed the S&P500, which rose 7.3% in Q3 2018. The 12.8% increase in the A&D Index mirrors the sharp increase in the defense budget for the second consecutive year.
- IOA Flow Control Index rose 7.8% in Q3 2018, outperforming the S&P500. It appears that the stock performance of companies in the index was positively affected by the 25% tariffs applied to a broad range of products imported from China. The tariffs, which were announced in April 2018, covered most pump products.

**Chart 6: IOA Aerospace & Defense Index vs. S&P500**

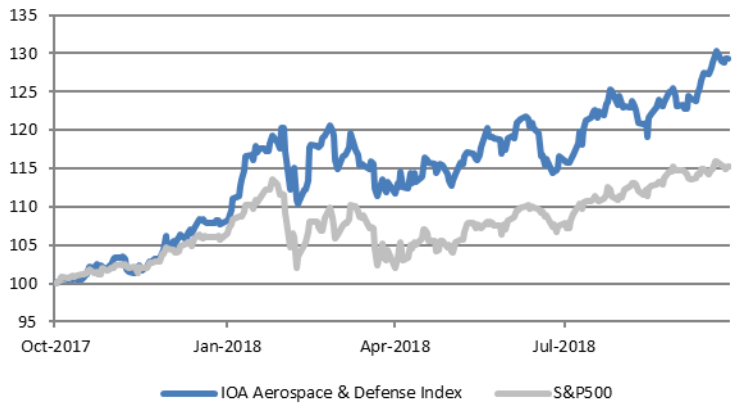



**Chart 7: IOA Automotive Index vs. S&P500**

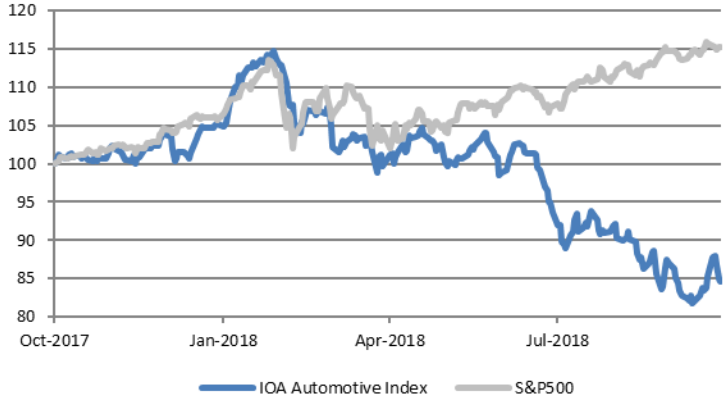
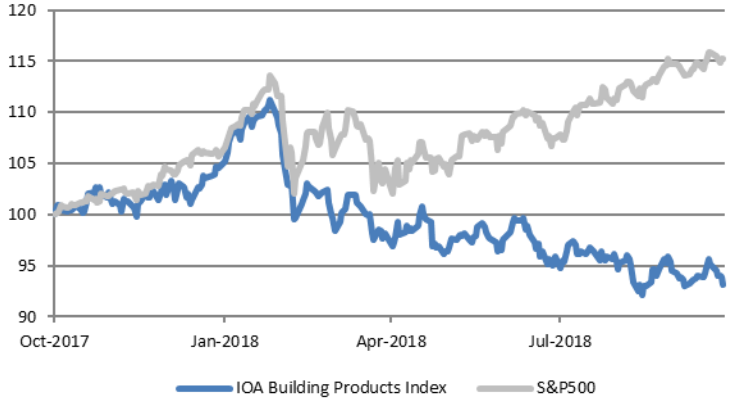



**Chart 8: IOA Building Products Index vs. S&P500**




*Source: S&P Capital IQ and InterOcean Advisors; data as of September 30, 2018*

**Chart 9: IOA Capital Equipment Index vs. S&P500**

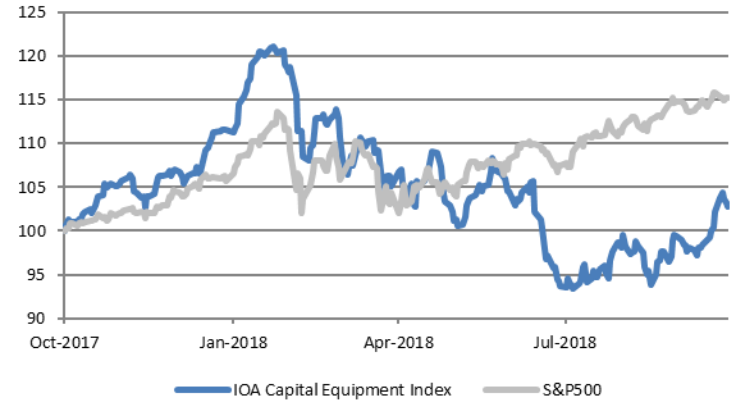



**Chart 10: IOA Distribution & Business Services Index vs. S&P500**

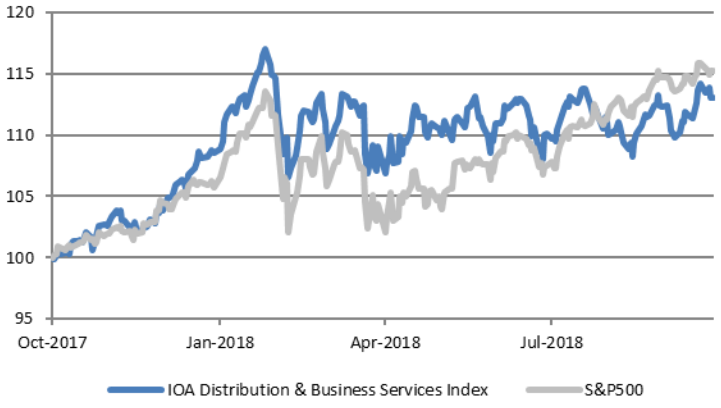



**Chart 11: IOA Electrical Products Index vs. S&P500**

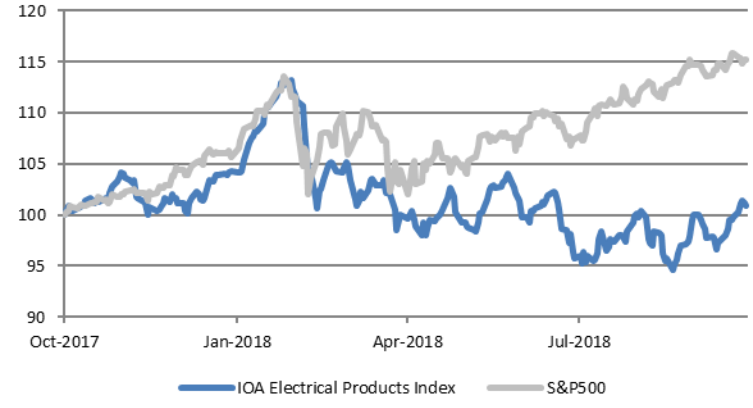



**Chart 12: IOA Flow Control Index vs. S&P500**

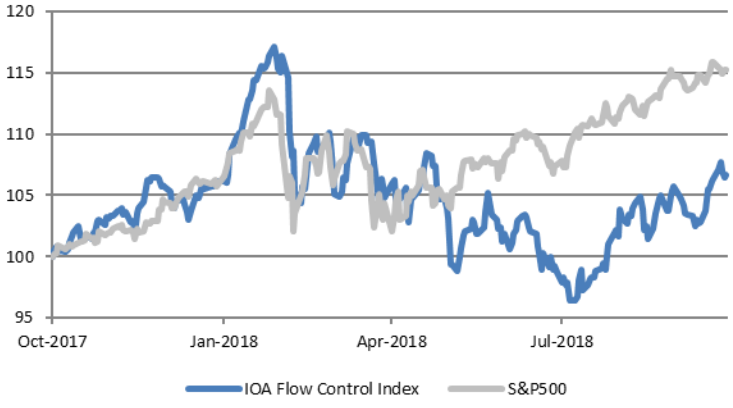



**Chart 13: IOA Metals Index vs. S&P500**

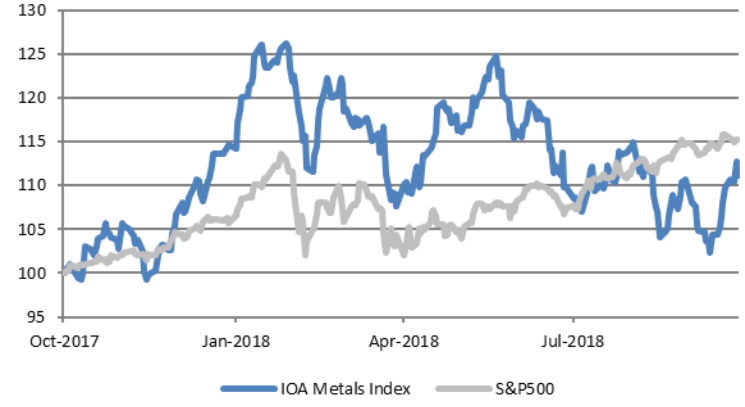
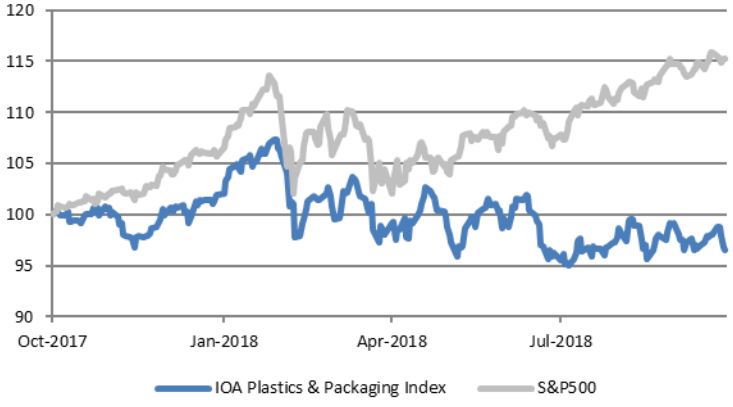



**Chart 14: IOA Plastics & Packaging Index vs. S&P500**




*Source: S&P Capital IQ and InterOcean Advisors; data as of September 30, 2018*

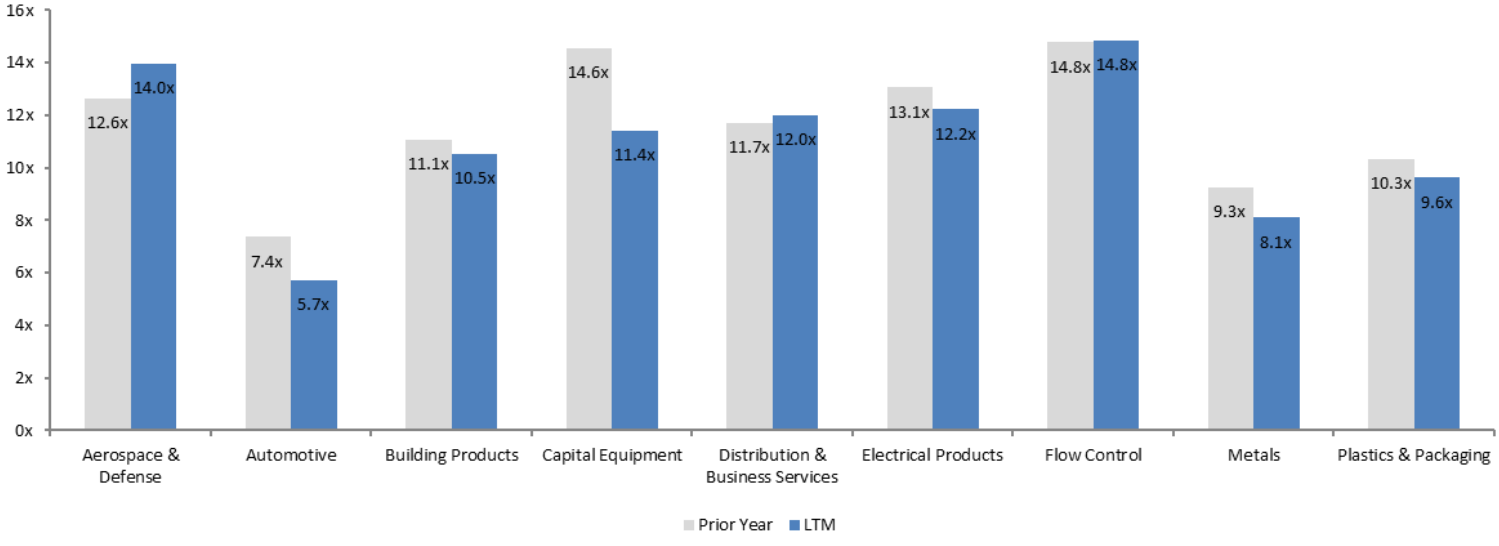
# Q3 Industry EBITDA Multiples Drop

The enterprise value / EBITDA multiple – a standard component of traditional corporate valuation exercises – decreased 0.7x from the composite indices one year ago. However, multiples still remain high in many of the sectors.

The Capital Equipment Index had the largest change in the multiple among IOA's indices, falling 3.1x in Q3 2018 compared to last year. Capital expenditures by industrial companies continued to be soft, as it appears that companies are deferring capex over fears that the strength of the U.S. economy is not sustainable.

The Building Products Index fell 0.6x as housing starts fell 3.4% in Q3 2018, and sales of existing homes were down for the eighth straight month. Building materials companies have been affected by the combination of rising mortgage rates, the new tax law provision that reduce incentives for home ownership and increased new home prices – caused by inflated commodity prices and a shortage of housing units.

**Chart 15: Median Enterprise Value/LTM EBITDA Multiples for IOA Index Companies**




*Source: S&P Capital IQ and InterOcean Advisors; data as of September 30, 2018*

## Disclaimers

*Certain members of InterOcean are registered representatives of and conduct securities transactions through StillPoint Capital, LLC, Tampa, FL. StillPoint Capital and InterOcean are not affiliated.*

*This is not an offer to sell securities or the solicitation of an offer to purchase securities. Any offer of securities may only be made pursuant to a written offering memorandum.*

*Recipients of this document must conduct their own appraisal and due diligence procedures before acting or refraining from acting on reliance on this document.*

# InterOcean Advisors LLC

## Investment Bank for the Manufacturing Sector

InterOcean is one of North America's leading specialty investment banks focused on serving the manufacturing sector. InterOcean advises corporations, private business owners, private equity groups and management teams, offering the following services:

- Mergers & Acquisitions
- Sale / Divestiture Advisory
- Private Capital Sourcing (Debt and Equity)
- Financial Advisory

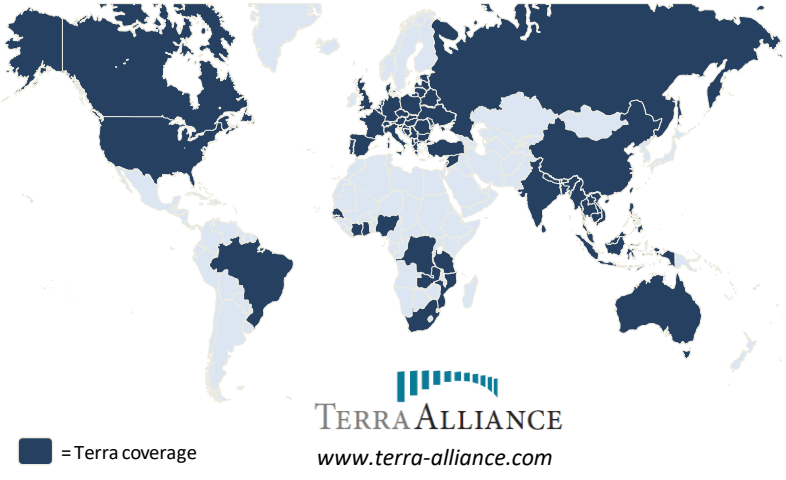
To learn more about InterOcean, please visit our website at: www.ioadvisors.com

## Industry Expertise

InterOcean is dedicated to providing solutions for the aerospace & defense, automotive, building products, capital equipment, distribution & business services, electrical products, flow control, metals and plastics & packaging segments of the economy. Our deep experience in these industries facilitates the identification of important industry and market trends, a company's key value drivers and qualified buyers, lenders and investors, thereby improving the likelihood of a transaction closing at a premium value and on a timely basis.

## International Capabilities

InterOcean is a member of the Terra Corporate Finance Alliance, a growing international alliance of investment banks with operations in North America, South America, Europe, the Middle East, Africa and Asia. Through this network, InterOcean has a platform for offering enhanced identification of, and access to, potential transaction parties around the globe. Collectively, over the past few years, the Terra network has advised on more than 200 M&A transactions with a total value in excess of USD $10 billion.




## Executive Team

**William Doepke**
Managing Director
wdoepke@ioadvisors.com
+1 312 698 6906

**Mark Harvey**
Managing Director
mharvey@ioadvisors.com
+1 312 698 6915

**Nicholas Newlin**
Managing Director
nnewlin@ioadvisors.com
+1 312 698 6918

**Robert Wujtowicz**
Managing Director
rwujtowicz@ioadvisors.com
+1 312 698 6904

*All Managing Directors listed above are Registered Representatives*