WINTER 2021

INDUSTRY INSIGHTS

Global Packaging

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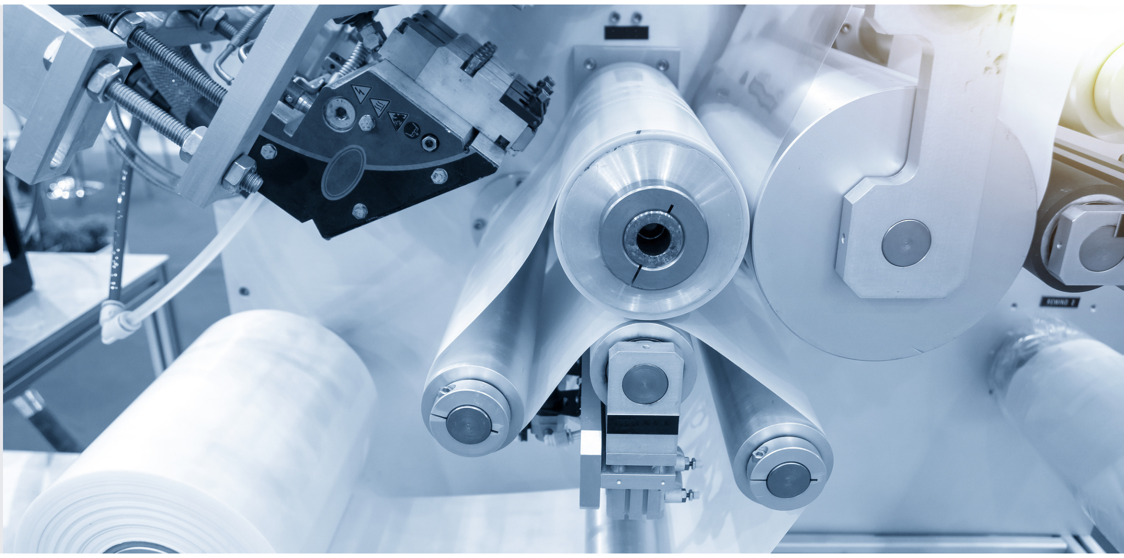
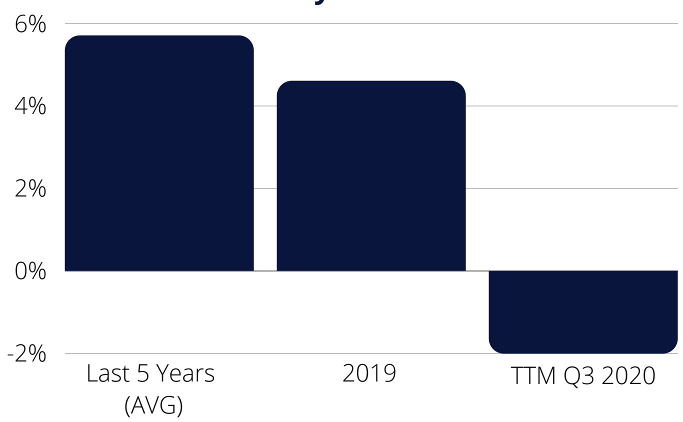


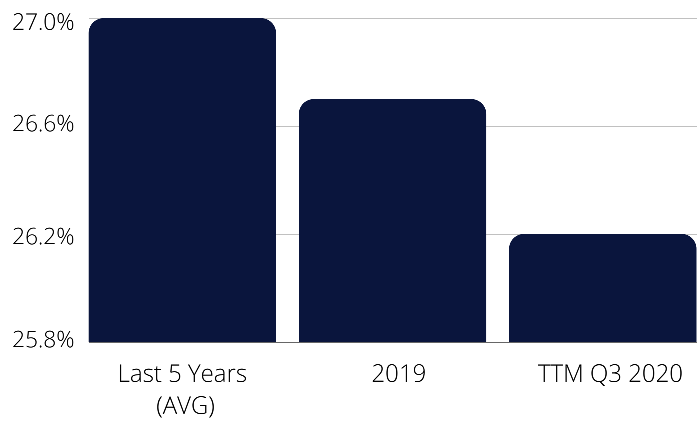
OPERATING & FINANCIAL PERFORMANCE

With 2020 finally behind us, we can see how the global pandemic impacted the packaging industry and, more specifically, packaging mergers & acquisitions. Overall, Packaging fared better than many sectors of the economy. This was in part driven by a large portion of packaging destined for inelastic markets such as food, personal care, and healthcare as well as a favorable raw material environment for the better part of the year. However, a deeper dive into the various packaging end markets leads to a wide array of year-over-year results for sales and volumes. For instance, packaging for products distributed through grocery, retail, and e-commerce performed strongly in comparison to underperforming markets like hospitality, foodservice, and non-grocery retail. Beyond demand implications, 2020's challenges included adopting new workplace safety protocols, managing employee turnover in the face of government subsidies, and navigating PPP filing/forgiveness requirements. The overall result for the industry was positive—muted sales declines, resilient gross margins—and by year-end, a slightly improved market for M&A. These results provide optimism headed into 2021.

Publicly Traded Packaging Companies Year-over-year Sales Growth



Gross Margin %

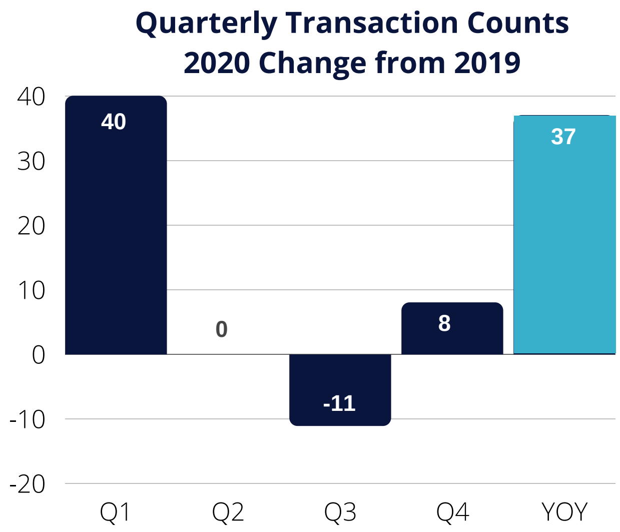


Source: Mazzone & Associates research, Pitchbook, and company filings

DEAL METRICS

DEAL VOLUME

The overall resilient performance of the Packaging Industry translated to strong M&A activity, which by year end 2020 matched and even surpassed the volumes witnessed in 2019. Deal volumes in Q1 outperformed 2019 volumes in each of the first three months of 2020, but these improved volumes subsided in April when processes that launched later or that were due for completion after quarantines went into effect were postponed or cancelled. By Q3, year-over-year comparisons entered negative territory. In particular, cross-regional deals suffered, ending the year down 10% versus 2019.

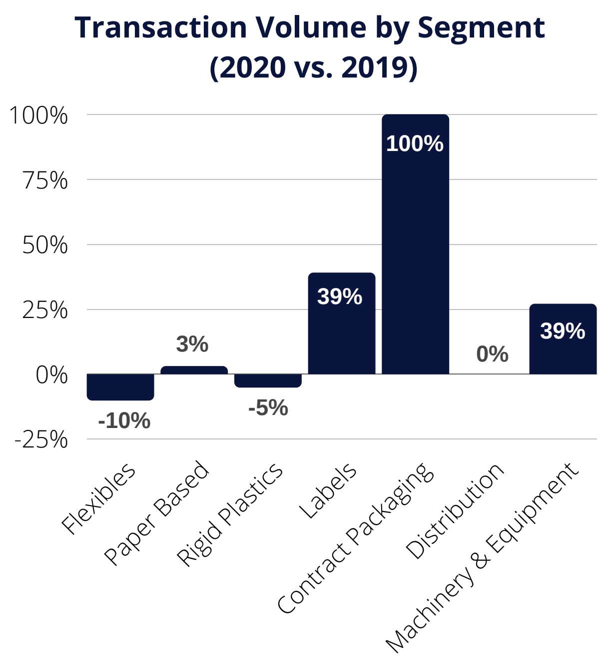


A rebound in December, however, kept the full year at a positive year-over-year comparison. We believe that the December results foreshadow further rebounding in deal volume for 2021. Increasing optimism regarding the availability of vaccines for COVID-19, the removal of uncertainty around the US election cycle, and owners looking to exit after the COVID-19 "fog" has passed have set the stage for meeting pent-up demand (and supply) of packaging acquisitions.

It is instructive to consider packaging M&A activity in the context of the overall marketplace, which saw an overall downtown in M&A activity in 2020 (-3.5%). Interestingly, larger transactions (over $100M in value) saw a greater volume decrease (-7.9%), while smaller transactions (values less than $100M) saw only a -2.5% decrease. As packaging M&A is largely driven by smaller transactions, it is not surprising that this market fared better versus overall global mid-market transactions.*

Segment analysis reveals interesting trends among deal volumes across the packaging spectrum:

Flexibles and Rigid Plastics are historically popular markets for consolidation and are attractive for both corporate and private equity investors. In 2020, however, these were the only product segments to witness a decline in absolute deal volume. One year does not make a trend, but this bears watching. One possible cause for softening interest is that acquirers are reacting to the persistent, negative sustainability perception around plastic packaging. Unless and until plastic packaging converters can address this issue, this may cloud the investment opportunities in these segments.

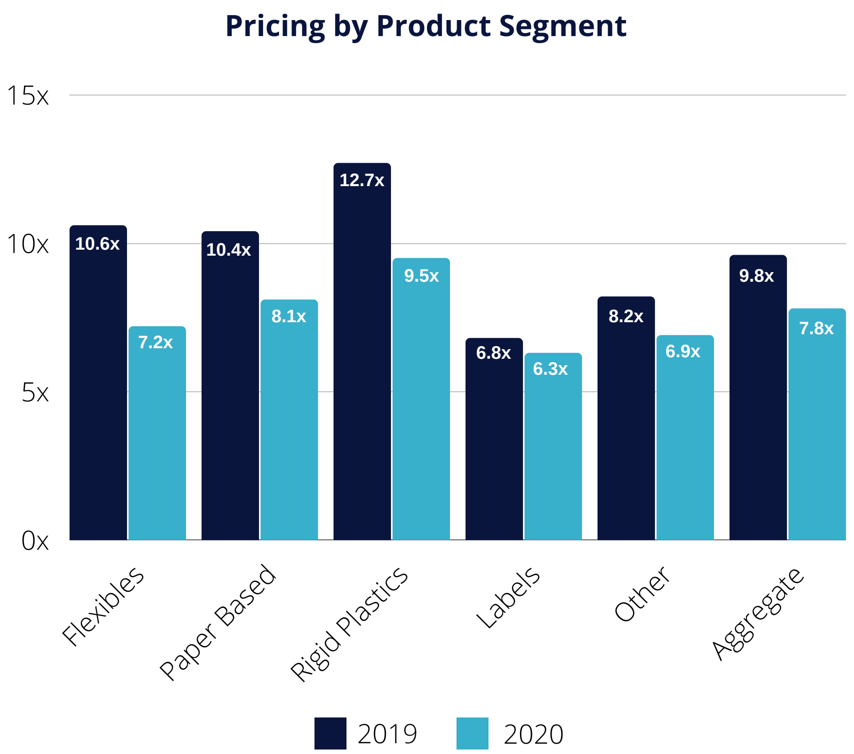


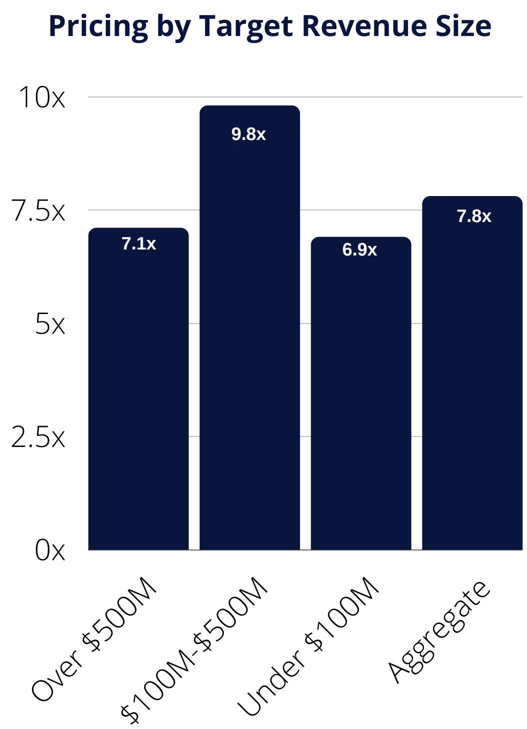
*Source for overall market data Dealogic

DEAL PRICING

Pricing in Packaging M&A transactions broadly declined in 2020, with EBITDA Multiples declining on average by just under 2 turns and Revenue Multiples declining on average by ¼ turn. The softness in pricing was pronounced in the middle two quarters of the year, each averaging 7x EBITDA, while the bookend quarters both exceeded 8x EBITDA. Again, we believe that the stronger year-end performance is indicative of a return to more recent historical levels of valuation. This pattern mirrors the publicly traded packaging stocks, which lost nearly 2 turns of EBITDA from Q1 to the market's March low point, but then rebounded by year end.

Transaction pricing decreased across all product segments, with Flexibles and Rigid Plastics suffering the largest decrease. We saw a few cases in which buyers were cautious on EBITDA valuations given the favorable material input pricing for 2019/20. Buyers pointed to this as a transitory improvement in margins and were thus more cautious on EBITDA multiples. On the other hand, and owing to the numerous consolidators in the Label segment, these transactions saw the least decline (albeit, on an overall lower multiple):

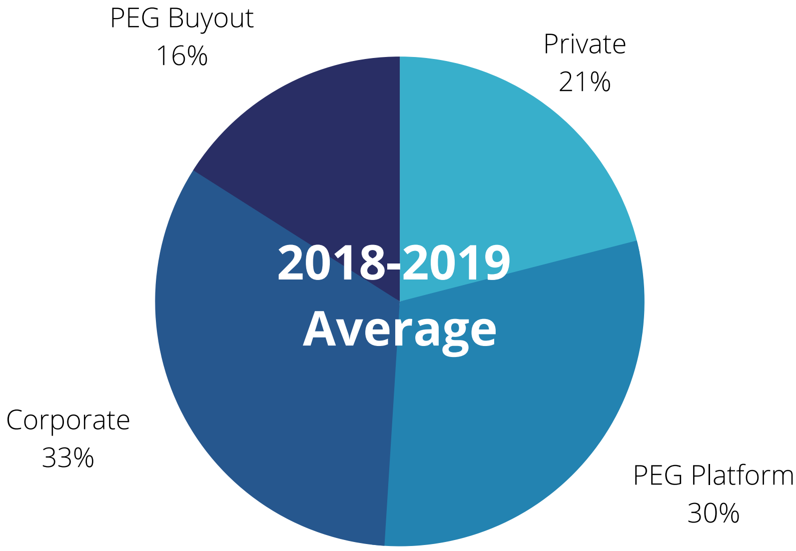


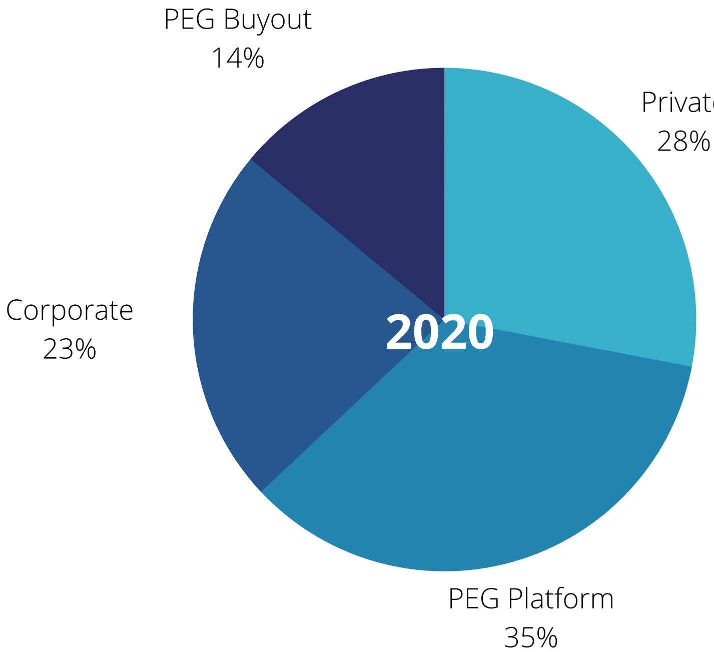


We also note that the market still favors the "mid-sized packaging company," with a persistent premium paid for those targets with revenues of $100 to $500 million. Consistent with prior periods, these targets traded at a ~2x premium to both larger and smaller revenue targets.

ACTIVE BUYERS & SELLERS

Not surprisingly, the composition of active buyers shifted in the COVID-19 economy. Both Corporate buyers and new Private Equity buyouts (new platforms) transacted proportionately fewer packaging transactions in 2020, with Private acquirers and Private Equity-backed Platforms filling the gap. We surmise that during the uncertainty of the pandemic, private buyers (longer-term investment horizon) and Private Equity platforms add-ons (versus "riskier" new platforms) were better positioned to get deals done.





All buyer groups paid less in 2020 on average. We note that Private Equity Groups Private and Corporate Buyers trimmed valuations by less than 2 turns of EBITDA while Private Equity buyers (both new platform buyouts and platform add-ons) reduced pricing by an average exceeding two turns of EBITDA.

IMPACTS & OPPORTUNITIES

Here are some of the factors that we are watching to inform clients on M&A and financing as we look to the balance of 2020 and into 2021:

VISIBILITY & CONFIDENCE

2020 saw multiple end markets variously impacted by changes in consumer behavior, distribution and regulations. This made forecasting in 2020 particularly difficult for owners and management teams, which spilled into committing capital investments, securing financing and buying/selling a company. While the emergence of vaccines for COVID-19 creates optimism, it remains difficult to confidently forecast and plan. The resurgence in activity witnessed in December is likely to continue but can easily be derailed by concerns surrounding vaccine distribution and efficacy or other economic disruptions. **Prognosis is that the economic and M&A recoveries are real, yet fragile and susceptible to interference.**

QUALIFYING AS AN "A ASSET"

The counter to the above is that Packaging has been a resilient segment in the COVID-19 economy, with numerous packaging companies quoting excellent performance in 2020. Where lenders pulled back new financing and availability of capital in other industries, Packaging continued to be well-supported by debt groups. The previous flexibility shown towards more levered packaging companies has been tempered, however, drawing the largest public strategic buyers to focus on smaller companies with differentiating technology and capabilities. **Companies that have shown persistent growth and margins qualify as an “A Asset” and can still obtain financing to execute on strategic priorities and command premium pricing in the M&A market.**

TAXES

For our US readers, this could be a significant development. As of this writing, the new Biden administration is just settling in, and it is not clear (or even likely) how much of his platform will be achievable with the divided Senate. Biden’s tax proposal during the campaign would call for substantial changes in the tax code: an increase in corporate tax rates, increasing the long-term capital gains tax rate, limiting inter-generational wealth transfers, and subjecting all wages to the Social Security payroll tax, among other items. **We expect some private business owners to accelerate their exit/monetization plans in anticipation of a less favorable tax regime.**

PROCESSES

We have all now adapted to social distancing protocols, which included conducting M&A processes remotely—virtual due diligence, video-conferenced management meetings, etc. While not viewed as optimal at the time, these virtual practices can set the stage for quicker, efficient deal timelines. Speed is a tactical advantage in M&A. **Buyers who effectively adopt these new approaches can capitalize on an advantage in the post-COVID-19 market.**

AREAS OF FOCUS FOR PREMIUM VALUATIONS

The search for above-average growth and value-add has long led investors to markets such as healthcare/pharmaceutical (which in turn has led to high pricing for these assets). We continue to look not only at these historically popular markets, but also to alternatives to drive premium value:

Supply Chain	This issue arose in January 2020 and, given the ongoing US/China tensions, will persist/accelerate after Covid is contained. We advise all buyers and seller to carefully understand and proactively manage their supply chain. This may also present growth opportunities for near-shoring geographies such as Mexico (for the US/Canada) and Turkey (for Europe).
Automation	As noted above, efficiency and reliability of labor input became problematic for some firms during this recent crisis. We believe extra value is warranted for firms that either use or supply a high degree of automation versus focusing on low-cost countries to manage labor content.
E-Commerce	E-commerce sales are growing significantly in this economy, among both established product markets and with expansion into new categories (grocery). 2020 e-commerce sales substantially increased over 2019 while still representing a relatively small percentage of overall retail sales. We like firms providing cost-effective protective packaging and that can effectively bridge from brick-and-mortar to e-commerce presentation.
Mass Customization	While CPGs have recently enjoyed a resurgence among their big brands, we view as inevitable the long-term trend to smaller brands and more personalized products. E-commerce will accelerate this trend, as our “local store” becomes the entire available market. Find packaging companies that cater to these brands by effectively producing a large number of SKUS in ever shorter runs.
Sustainability	For years, sustainability has been a catchword for packaging, particularly among resin-based and consumer-facing packaging. Historically, many companies have paid lip service to "sustainability" to address this necessary evil, for example, citing customer-driven, cost saving down-gauging as “sustainable practices.” This was perhaps excusable as end customers (CPGs and consumers) historically showed zero interest in paying for sustainability. That paradigm is changing. The lip service previously communicated by brand owners is now resulting in “commitments,” and consumers are demanding real change. Although North America lags Europe in regards to recycling infrastructure (lower recovery rates, insufficient sortation and poor consumer education/incentives), increasing investment and innovation are driving a push towards a reality of sustainable packaging models in the North American market. Companies who develop technology and commercialize products which are truly sustainable will separate themselves from the pack. We now see buyers acknowledging this and placing a premium on targets that deliver these products and practices.

SUMMARY

We encourage you to contact us with questions or thoughts as we continue to find our footing coming out of a difficult 2020. With our transaction and industry experience advising clients on sales, acquisitions, and financing activity in companies across the industry, Mazzone & Associates is well-positioned to provide our packaging clients with the expertise needed to create value in today's market.

MAZZONE & ASSOCIATES CURRENT PACKAGING MANDATES

Category	Mandate	Client Type	Geography
Flexibles (paper & plastic)	Buy Side (search)	Private	EMEA (into N. Amer)
Packaging	Buy Side (search)	Private Equity	North America
Labels	Buy Side (specific asset)	Corporate	Asia into N. America
Rigid Plastics	Debt Placement	Private	Global
Flexibles	Valuation	Private	North America
Flexibles	Sell Side (pending)	Private	North America

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