

November 2020

Investment Banking

**COVID-19's Impact on
Specialty Distribution**

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Specialty Distribution



COVID-19's Impact on Specialty Distribution

The pandemic has pressured supply chains across industries, but the net impact has varied significantly depending on the end-market.

Before the COVID-19 pandemic, supply chains in many industries were already an area of focus or in a state of transition because of geopolitics and the macroeconomic environment. The pandemic then unleashed a host of unprecedented challenges for distribution networks, including rapid declines in demand, product shortages, the inability to meet in person with customers, and a forced shift to digital ordering.

As a result, every aspect of the specialty distribution industry has been acutely affected by COVID-19. Given the nature of the pandemic, however, the impact across end-markets has been highly uneven, with many subsectors experiencing countervailing headwinds and tailwinds of varying magnitudes. The COVID-19 pandemic has also highlighted the importance of strong supply chains and the value of relationships with distributors that have buying power, contingency plans, and advanced digital capabilities.

In fourth quarter 2020 and heading into 2021, specialty distributors continue to deal with uncertainty while thinking about how to invest in capabilities and offerings that will strengthen their businesses for the remaining stages of the pandemic and beyond.

Analyzing COVID-19's Impact by Subsector

As noted above, the pandemic's impact on specialty distributors has varied significantly by subsector. For most end-markets, the net impact has been negative, but surging demand for safety products and other idiosyncratic knock-on effects of social distancing and work-from-home have provided a buffer, and demand trends and overall market sentiment have been improving over the past several months. We examine these dynamics in several key subsectors of specialty distribution.

- **Industrial MRO:** Industrial maintenance, repair, and operations (MRO) was among the hardest-hit segments of the specialty distribution industry. Since April, safety sales have moderated and non-safety sales have gradually recovered. While the theme of gradual recovery remains intact, the industrial economy remains soft. In a William Blair report on Fastenal dated October 13, 2020, Fastenal management noted that customer activity (sales) is down in the midsingle digits from pre-COVID levels.
- **Safety, healthcare, and broadline consumables:** Sales of safety, sanitation, and personal protective equipment (PPE) have surged throughout the pandemic. This unprecedented demand provided a much-needed counterbalance to falling demand in other areas but also exposed weaknesses in both healthcare and industrial supply chains. In their September 9 report, William Blair Equity Research analysts Ryan Merkel and John

Kreger noted that they expect "surge" safety sales to continue through the rest of 2020. This creates an opportunity for distributors to convert these surge-safety customers into long-term customers and further expand into government and education verticals.

The analysts noted that sales of PPE and infection control products will provide a supportive floor in demand for healthcare distributors once visits to healthcare providers normalize; this benefit, however, likely will not be large enough to offset long-term headwinds from customer and supplier consolidation. The analysts also noted that for industrial distributors, gross margins for safety products are smaller than typical margins across their entire portfolios; many distributors are selling safety products at close to breakeven points just to serve customers.

- **HVAC:** Because the pandemic first accelerated in the spring when temperatures were mild across most of the United States, the impact on heating, ventilation, and air conditioning (HVAC) distributors was initially muted. But as temperatures increased throughout the summer, disruptions in the supply chain began to emerge—a dynamic that was exacerbated by the fact that many Americans were working from home.

In a July 16 report, Merkel noted that many HVAC original equipment manufacturers (OEMs) were experiencing supply chain

issues due to factory shutdowns and/or logistical issues.

- **Building and construction:** Many construction projects were put on pause or experienced significant delays in the second quarter because of social distancing restrictions. Contractors that were moving forward on projects had to deal with supply disruptions, a dynamic that has continued into the fourth quarter.

Residential repair and remodel end-markets, however, have been a major bright spot for building and construction distributors. In a July 7 report, Merkel noted that he expects this subsector to continue to surprise to the upside through the end of 2020 due to stay-at-home restrictions, pent up demand as states reopen, and rising home values. Merkel noted that the summer spike in COVID-19 cases was particularly bullish for outdoor living projects.

Digital Shift Accelerates— and What It Means for Amazon

The shift toward e-commerce in B2B markets had been much slower than what has occurred in B2C markets over the past decade. The COVID-19 pandemic, however, has been an inflection point in digital penetration for business buyers. In their September 9 report, Merkel and Kreger note that distributors are reporting a spike in e-commerce user accounts and accelerating growth through their digital channels.

Amazon Business (the latest iteration of Amazon's B2B platform) certainly benefits from these broader trends. But, as we have discussed in previous years' reports, the threat of Amazon

disrupting the B2B market and driving down MRO prices is largely overstated. This is because of a host of factors that are specific to B2B purchasing, including the importance of high-touch customer service, value-added product expertise, and a focus on total cost of ownership among B2B buyers. We expect that Amazon's greatest opportunity to make significant inroads in the B2B market may be in tail spending (low dollar, infrequent purchases).

The pandemic has also drastically increased "contactless" forms of shopping, especially in last-mile consumer categories like grocery. Grocery is a hugely important growth area for Amazon, but one shouldn't assume that Amazon's success in B2B more broadly will translate to Amazon Fresh (Amazon's grocery delivery service). In-house fulfillment is vital to success in grocery delivery given the perishable nature of the goods and other factors. It remains to be seen what fulfillment strategy Amazon will pursue, how effective Amazon will be in integrating its delivery services with its Whole Foods physical locations, and what these learnings mean for Amazon's B2B strategies and last-mile delivery model.

How Onshoring Affects Specialty Distributors

The U.S.-China trade wars since 2018 have spurred momentum for localization of supply chains and onshoring of manufacturing and distribution capabilities. The COVID-19 pandemic added fuel to the fire by exposing how China's role as the "world's factory" could lead to disruptions that ripple across global supply chains. This risk was especially acute when it came to delays in PPE

production and concerns about drug manufacturing. The pandemic could be a catalyst for CEOs to increase their efforts to diversify their supply chains and onshore additional manufacturing and distribution capabilities.

M&A Surges after Spring Slowdown

In April and May, dealmaking activity slowed significantly as many companies put their processes on pause amid the heightened uncertainty. In the summer, though, public market investors, strategic acquirers, and financial sponsors began looking beyond 2020's uncertainty and focusing on longer-term opportunities. This, along with the backlog of previously paused transactions, led to a surge in dealmaking starting in the late summer.

Specialty distributors are seen as a relatively low-volatility way for investors and financial sponsors to get access to the highly cyclical industrials sector. Many distributors showed relatively impressive resilience during the pandemic by being able to quickly shift to PPE, sanitation, and other surging categories.

Other factors driving dealmaking in specialty distribution are the increased need for scale and leading digital capabilities. The pandemic highlighted the importance of these qualities, as larger distributors were better equipped to provide uninterrupted service and e-commerce adoption accelerated. Strategic acquirers and financial sponsors are becoming increasingly aggressive in pursuing opportunities in these areas.

Specialty Distribution Market Analysis

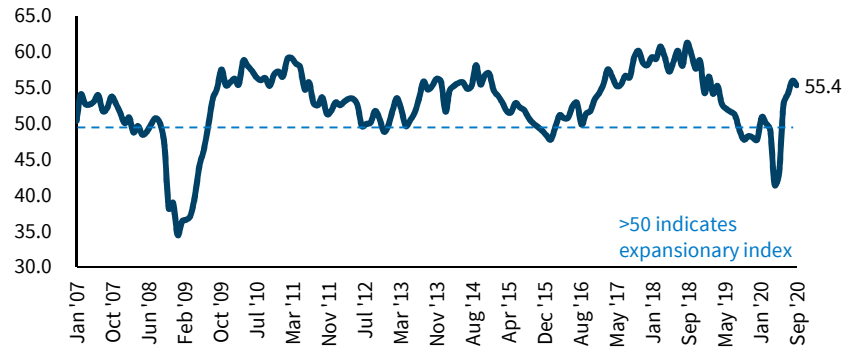
We look behind the numbers to examine the market dynamics that are driving trends in the dealmaking and capital-raising landscape in the specialty distribution industry.

Industrial Activity Slowdown Amid COVID-19

The drastic slowdown in industrial activity during the early stages of the pandemic was a major headwind for specialty distributors. This negative impact, however, was partly offset by distributors' ability to shift to PPE and other safety supplies.

U.S. ISM Manufacturing PMI®

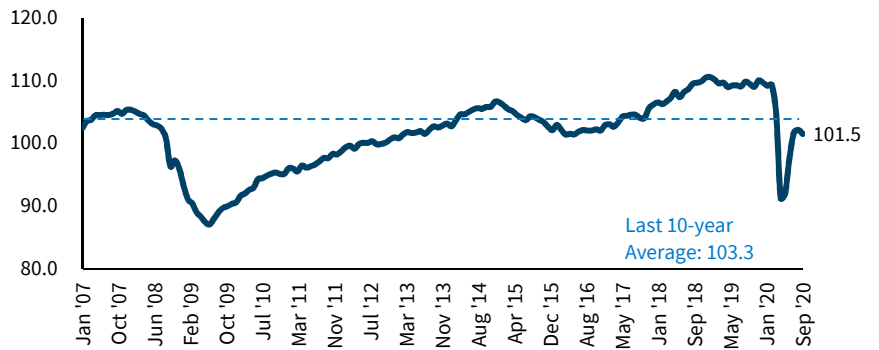
(Based on a survey of manufacturing supply executives conducted by the Institute of Supply Management)



Sources: PMI® and Institute for Supply Management® (ismrob.org)

U.S. Industrial Production Index

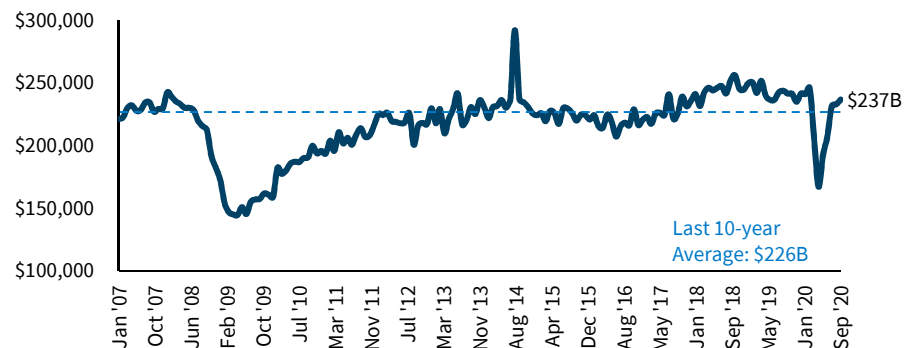
(2012=100, Seasonally Adjusted)



Sources: Federal Reserve Board

Manufacturers' New Orders: Durable Goods

(Millions of Dollars, Seasonally Adjusted)

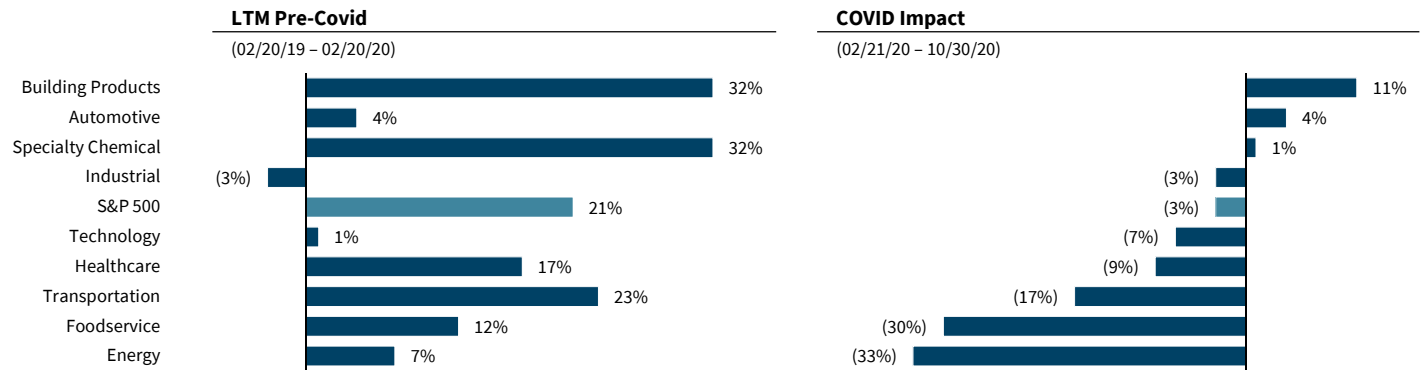


Sources: Federal Reserve Board

Performance of Specialty Distribution Subsector Indexes

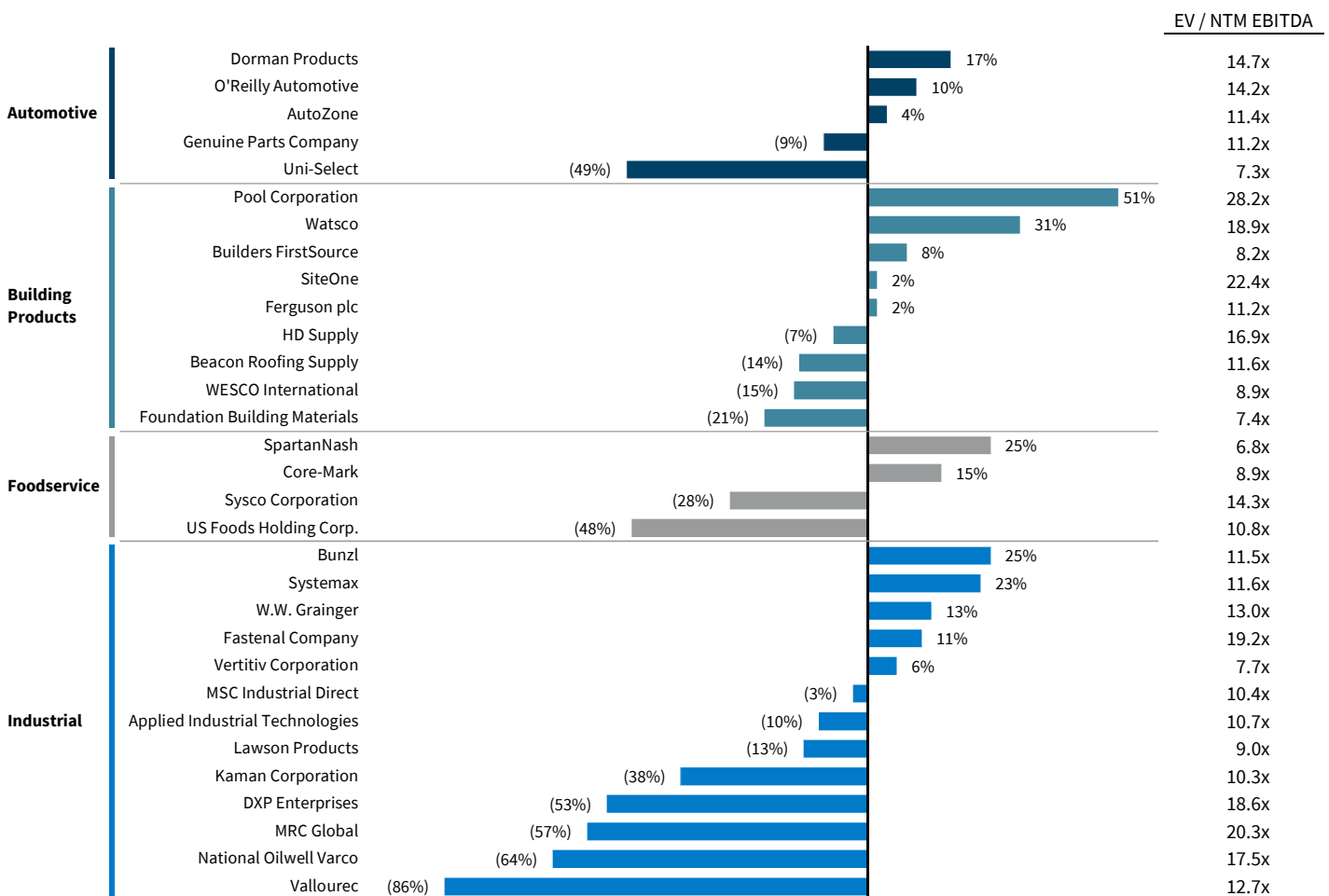
The pandemic's effect on specialty distributors has varied significantly across subsectors. This is reflected in the uneven performance of specialty distribution indexes since February.

Sector Indices Performance⁽¹⁾



Recent Share Price Performance for Select Distributors

(02/20/20 - 10/30/20)



Source: Capital IQ as of October 30, 2020

Automotive: AZO, DORM, GPC, ORLY, UNS; Building Products: BECN, BLDR, FERG, FBM, HDS, POOL, SITE, WCC, WSO; Energy: DCP, ENB, GLP, SPH, UGI; Foodservice: CORE, SPTN, SYU, USFD; Healthcare: AHCO, ABC, CAH, HSIC, MCK, OMI, PDCO; Industrial: AIT, BNZL, DXPE, FAST, GWW, KAMN, LAWS, MRC, MSM, NOV, SYX, VK, VRTY; Specialty Chemical: AI, APD, BNR, HWKN, LIN, UNVR; Technology: ARW, AVT, NSIT, SCSC, TECD; Transportation: AIR, FTT, HEI, LKQ, TITN, TGI

(1) Indices are weighted by market capitalization

Specialty Distribution Valuations by Subsector

Public equity multiples in most specialty distribution subsectors have returned to or exceeded pre-COVID levels. These valuation rebounds, however, might overstate the actual strength of these subsectors. For many companies, valuations have been distorted by a depressed denominator, with EBITDA rapidly declining, coupled with a broader equity market rebound fueled by massive stimulus efforts globally.

EV / NTM EBITDA ⁽¹⁾	As of 02/20/20		As of 10/30/20		Change in EV / NTM EBITDA Multiple Δ since 2/20/20 to 10/30/20	
	Value	Label	Value	Label	Δ Multiple	% Change
Industrial	12.2x	12.2x	13.8x	13.8x	1.6x	13%
Specialty Chemical	13.8x	13.8x	13.6x	13.6x	(0.2x)	(1%)
Building Products	12.2x	12.2x	13.5x	13.5x	1.3x	10%
Transportation	13.0x	13.0x	12.9x	12.9x	(0.1x)	(1%)
Foodservice	11.9x	11.9x	12.8x	12.8x	0.9x	7%
Automotive	13.4x	13.4x	12.4x	12.4x	(1.0x)	(7%)
Energy	12.7x	12.7x	10.5x	10.5x	(2.2x)	(17%)
Healthcare	9.4x	9.4x	8.0x	8.0x	(1.4x)	(15%)
Technology	8.2x	8.2x	7.4x	7.4x	(0.8x)	(10%)

Source: Capital IQ as of October 30, 2020

Automotive: AZO, DORM, GPC, ORLY, UNS; Building Products: BECN, BLDR, FERG, FBM, HDS, POOL, SITE, WCC, WSO; Energy: DCP, ENB, GLP, SPH, UGI; Foodservice: CORE, SPTN, SYX, USFD; Healthcare: AHCO, ABC, CAH, HSIC, MCK, OMI, PDCO; Industrial: AIT, BNZL, DXPE, FAST, GWW, KAMN, LAWS, MRC, MSM, NOV, SYX, VK, VRTV; Specialty Chemical: AI, APD, BNR, HWKN, LIN, UNVR; Technology: ARW, AVT, NSIT, SCSC, TECD; Transportation: AIR, FTT, HEI, LKQ, TITN, TGI

(1) Indices are weighted by market capitalization

Specialty Distribution M&A Transactions Since 2015

Specialty distribution platform companies have typically traded in the 10x–13x EV/EBITDA multiple range. The relative resilience that many distributors showed during the pandemic, including the ability to quickly pivot to PPE and other surge items, has caused many financial sponsors to view distributors as a less-cyclical way to gain exposure to industrials.

Notable Distribution Transactions

(\$ in millions)

Date	Target	Acquirer	EV	EV/ EBITDA	Date	Target	Acquirer	EV	EV/ EBITDA
Pending	HD Supply	Home Depot	\$8,118	16.5x	18-Mar	LifeHealthcare Group	Pacific Equity Partners	NA	10.2x
Pending	Foundation Building Material	American Securities	1,370	8.4x	18-Feb	SupplyOne	Wellspring Capital Management	Confidential	
Pending	US LBM	Bain Capital	NA	NA	18-Jan	FCx Performance	Applied Industrial Technologies	784	12.5x
20-Nov	Vesco Holdings	Gryphon	Confidential		18-Jan	A.H. Harris	HD Supply Holdings, Inc.	380	9.0x
20-Oct	Windy City Wire	Diploma PLC	465	~11x	17-Dec	Northeast Veterinary Supply	AmerisourceBergen	Confidential	
20-Oct	Maroon Group	Barentz International	NA	NA	17-Sep	Stewart & Stevenson LLC	Kirby Corporation	754	11.0x
20-Oct	Energy Distribution Partners	PPC, Concentric, Duchossois	NA	NA	17-Sep	All American Containers	Veritiv Corporation	177	9.0x
20-Oct	Parts Authority	Kohlberg & Company, LLC	NA	~12x	17-Aug	TriMark	Centerbridge Partners	NA	10.7x
20-Aug	MCR Safety	Bunzl	NA	NA	17-Jun	Core & Main	Clayton, Dubilier & Rice	2,400	10.0x
20-Aug	HD Supply C&I White Cap	Clayton, Dubilier & Rice	2,900	9.0x	17-May	Southern Anesthesia & Surgical	Henry Schein	Confidential	
20-Jun	Fabory Nederland B.V.	Torqx Capital Partners	NA	NA	17-May	Dade Paper	Audax / Imperial Bag & Paper	NA	13.0x
20-May	North American and Waxie Sanitary Supply	FEMSA	Confidential		17-May	Empire Resources, Inc.	Ta Chen Stainless Pipe Co.	180	19.9x
20-Jan	Anixter International	WESCO	4,500	9.9x	17-May	GranQuartz	The Stephens Group	Confidential	
19-Sep	Hilco Vision	Windjammer Capital Investors	NA	13.5x	17-May	VWR	Avantor (New Mountain)	NA	NA
19-Sep	Todd Pipe & Supply	MORSCO	160	9.8x	17-Jan	Parts Town	Berkshire Partners	NA	NA
19-Aug	Wesco Aircraft Holdings, Inc.	Platinum Equity	1,904	13.5x	16-Dec	QC Supply	Charlesbank Capital Partners	Confidential	
19-Jun	Kaman Distribution	Littlejohn & Co.	700	10.6x	16-Nov	TricorBraun Holdings	AEA Investors	NA	11.0x
19-May	Marketlab	Windquest	Confidential		16-Jul	Premier Farnell plc	Avnet, Inc.	1,062	12.7x
19-May	Imperial Dade	Bain Capital	NA	13.6x	16-Jul	RelaDyne	Audax	NA	9.5x
19-Mar	Nexeo Solutions	Univar	1,963	12.6x	16-Jul	Polyconcept	Charlesbank Capital Partners	Confidential	
19-Mar	Scrip Companies	Centre Lane Partners	Confidential		16-Apr	Momentum	Riverside Company	NA	12.0x
19-Jan	Flow Control Group	Bertram Capital	NA	13.0x	16-Mar	Nexeo Solutions LLC	WL Ross & Co LLC	1,550	11.5x
19-Jan	Essendant	Staples	976	10.5x	16-Feb	Brake Bros	Sysco	3,100	12.0x
18-Dec	4Refuel	Finning International Inc.	Confidential		16-Feb	National Distribution Contracting	Court Square Capital Partners	Confidential	
18-Nov	Clarios	CDPQ	11,600	7.9x	16-Jan	Dade Paper	Audax	NA	10.0x
18-Jul	Kondor	DCC plc	Confidential		16-Jan	WolfGordon	Saw Mill Capital	Confidential	
18-May	3Wire (Foodservice Business Unit)	Parts Town	Confidential		15-Oct	Koda Distribution	Azelis	Confidential	
18-May	Halo Branded Solutions	TPG Growth	Confidential		15-Jul	Zee Medical	Cintas Corporation	Confidential	
18-Apr	SRS Distribution	Leonard Green & Partners	NA	16.0x	15-Jul	USLBM	Kelso & Company	NA	9.2x
18-Apr	Medical Specialties Distributors	McKesson	800	14.5x	15-Jul	HD Supply Power Solutions	Anixter International	825	10.4x
18-Mar	Sarnova	Patricia Industries	NA	13.6x	15-May	Victory Packaging	KapStone	640	10.4x

Source: Capital IQ, Dealogic, and William Blair Equity Research

Drawing on our deep sector expertise and the strength of our relationships with buyers around the world, William Blair has built a leading specialty distribution banking franchise. Business owners turn to us for outstanding execution for their M&A and capital raising objectives.

Recent transactions include:

Not Disclosed



a portfolio company of
O2 Investment Partners, LLC

has been acquired by



November 2020

Not Disclosed



has been acquired by



October 2020

\$465,000,000



has been acquired by



October 2020

Not Disclosed



have sold a majority controlling interest in the combined company to



May 2020

Not Disclosed



a portfolio company of
Berkshire Partners

has acquired



October 2019

Not Disclosed

NEDAC SORBO MASCOT

has been acquired by



March 2019

Not Disclosed



has been acquired by



January 2019

Not Disclosed



has been acquired by



June 2018

Not Disclosed



has been acquired by



May 2018

With more than 180 senior bankers around the world, William Blair has completed more than 1,050 advisory and financing transactions totaling nearly \$370 billion in value for our clients*

Specialty Distribution Investment Banking

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*In the past five years as of September 30, 2020