How Fast is Fast Enough? Advent International to acquire tech components manufacturer Laird for £1.2bn.

Laird plc (LON: LRD) – market cap as of 09/03/18: £979.8 m

Introduction

On March 1, 2018, Advent International announced it will acquire the UK electronic components producer Laird plc for £1.2bn, or £2/share. The deal marks yet another conquest for private equity firms in search for viable targets to employ their record amounts of cash on hand. At the same time, the deal marks a significant turning point for Lairds, one of the longest-lived manufacturing companies in the UK.

About Laird plc

Headquartered and listed in the UK, Laird was founded almost two centuries ago, in 1824, under the name of "Birkenhead Ironworks". By merging with Charles Cammell & Co in 1903, the new "Cammell-Laird" switched its business focus from ironworks manufacturing to shipbuilding. In that period, the company manufactured a wide variety of cruise liners and military ships such as Britain's first ever aircraft carrier - the HMS Ark Royal. In 1977, its shipbuilding business was nationalized and in 1989 it disposed of its railway operations, narrowing its scope to the development of electronic components. The company's name was eventually changed to Laird plc in 2008.

Laird nowadays employs c.10,000 people globally and is subdivided into two main segments: Performance Materials and Wireless Systems. The Performance Materials division designs electromagnetic shielding and heat management products. On the other hand, the Wireless Systems division designs and manufactures wireless antennae and modules. Laird plc boasts a wide variety of prestigious customers ranging from the commercial electronics sector - with smartphone producers such as Samsung and Apple - to the industrial and infrastructure sector, highlighting the versatility of the company's products and solutions.

In FY2017, the company reported a 17% increase in revenues to £937million and a corresponding surge in profits to £57m (up from last year's £122m net loss). Furthermore, in 2016 Laird suffered a profit warning due to discomforting data on smartphone production, which caused a c. 50% drop in its market capitalization. Finally, in February 2017 the company set up a £185m rights issue to control its debt burden, which now amounts to £164m.

About Advent International

Founded in Boston in 1984, Advent International is one of the most prominent US-based private equity firms. Since inception of its first fund in 1989, Advent has invested c.$39bn in more than 330 private equity investments and currently manages $42bn in AUM.

The company mainly focuses on five core sectors: Retail, TMT, Industrials, Healthcare and Financial Services. Returns for its investors are secured by adopting an operationally invasive oversight of its investments, particularly emphasizing ways to increase top-line and maintain a strong role in each company's management.

Among others, the company's portfolio currently includes companies such as the Italian payment services provider Nexi and Allnex, the German leading producer of industrial coating resins.

Industry Overview

Few industries are as intense and fast paced as the technology components one, which needs to stay constantly up to date with the latest trends and ever-increasing consumer demands. New technologies are constantly required and each new generation is progressively shorter lived than its predecessor. Furthermore, for any technology components manufacturer, each generation of products must be thought of as a train: failing to keep up with recent technological advancements – "missing the train" – entails losing treasured customers and getting replaced by the nearest competitor. Speed is key in such an industry: slower players are bound to succumb to quicker and more innovative counterparts.

The technology components industry is also characterized by thin profit margins: this is due to the immense pressure that tech component manufacturers have to endure from their customers, which are usually very large businesses with more than substantial bargaining power. A relatively small company like Laird deals with companies like Apple and BMW on a daily basis, where the major risks are profitability squeeze and replacement with an alternative competitor. In light of this, the key to success in this industry seems one: not having a direct competitor. Technology components manufacturer's main chance of success precisely relies on remaining innovative and guaranteeing a better value for their components than their second-best alternative competitor.

In the connectivity and antenna's submarket, in which Laird predominantly operates, the main goal is to be able to provide the fastest components at the best price. The advent of 5G, the fifth generation of cellular networks set to launch in 2020 and which promises connections capable of more than 3 gigabits per second at a frequency of more than 300 MHz, represents the next goal for component manufacturers. Furthermore, such generation is expected to be drastically different from its younger brothers, as the advent of IoT (or Internet of Things) has brought an entirely different paradigm to the industry. While on one hand we still seek the fastest connection, on the other, 5G will need to address also very small consumer and industrial electronics in the plethora of IoT which, differently from smartphones and computers, do not require fast speeds but can perfectly function at low speeds, though with higher reliability needs.

Lastly, as more and more products require to be connected, the industry is placing an ever-stronger emphasis on reliability and latency (the latter being the time which lapses from the moment when a signal is sent to when it is received). As an increasing number of devices and processes become automated, accuracy/latency is starting to bear the same weight as speed. In fact, speed will only continue to progress if it is accompanied by an equal stride in reliability. This can be easily shown in the driverless cars segment: these cars require to be constantly connected to a central server in order to drive autonomously; however, they do not only require faster speeds, but they also need more responsive latency and ironclad reliability to function properly. Today, 4G networks present a latency between 30 and 80 milliseconds: today, a car travelling at 130 km/h will move about 2.9 meters before receiving updated information on where to turn or stop, because of such a relatively low latency; 5G promises to have a latency measurable in microseconds and hence to reduce such difference to a few centimetres.

Deal Structure

Laird was valued at £1.2bn enterprise value (over 11x FY2017 EBITDA), to be paid entirely in cash. Under the terms of the agreement, shareholders will receive 200 pence (£2) in cash for each share held, leading to an equity value of around £1bn. The purchase price represents a premium of 72.6% over the closing price on the day before announcement of 115.9 pence: a very sizable premium, much higher than the average 30-50% paid for similar takeovers. Such a high premium, however, looks moderate if we consider that the company was trading at almost 290p/share up until mid-2016. Lower-than-expected data on the smartphone production outlook then generated a significantly adverse reaction from investors, who drove Laird's value down to trading levels similar to the pre-announcement ones.

Deal Rationale

From Laird's shareholders' perspective, the deal represents a significant capital gain event, as they will be getting a 73% premium on the pre-announcement price. However, the multiple paid for Laird does not look outstanding, as it is comparable to the one that the company enjoyed in 2015, before a massive earnings shortfall, a subsequent turnaround involving a successful £185m rights issue and a reduction in fixed costs and in the pay-out policy. Therefore, the purely capital gain explanation might not suffice to fully explain the company's shareholders' agreement to sell. Another possible rationale for them indeed lies in the uncertainty troubling the future of Laird: the saturation of the smartphone market has brought significant pressure on component producers, a phenomenon that the company indicated as the cause of its massive loss in 2016. Moreover, as noted before, Laird's client base is predominantly made up of companies the likes of Apple, whose significant size with respect to Laird might imply even more downward pressure on margins in the future.

In a takeover market where quality targets are getting scarcer, the Laird takeover represents a potentially high pay-off for Advent as well. Ultimately, Laird is a well-stablished engineering and technology company with solid opportunities for growth, cost cutting and ongoing divesting of non-synergistic businesses. Interesting prospects are in sight as well, with the antenna subsegment being affected by very strong growth. The company is expected to soon present its 5G components equipped with MIMO technology (a technology enabling the products equipped with it to connect from more antennas to various sources and hence boosting connection speed and reliability). By taking Laird private, Advent could do away with the capital market's focus on quarterly results and expectations and instead focus exclusively on long-term profitability.

Lastly, Advent has already announced that it is considering selling Laird's Connected Vehicles Solutions segment (include in the Wireless Systems division) - producing antennae for the automotive industry - to a larger auto-technology player. By spinning off such division, Advent could cash the proceeds of the synergies that the strategic acquirer would gain. At the same time, no significant impact on the rest of the group is expected, as Advent reportedly considers such a segment as a standalone unit of Laird's overall operations.

Market Reaction

The response from the market was clear about the acquisition: Laird rose by 73% from 117p to about 201p following the announcement of the acquisition. Such immediate rise shows investor's confidence in the deal and its prospective completion.

Financial Advisors

Laird was advised by JP Morgan Cazenove, Rothschild and Numis Securities, while Advent International was aided by Goldman Sachs and Citigroup.