

Fluid Power Industry Update

New Disruptions Emerge Beyond the Pandemic

Fluid power players that have persevered through the COVID-19 pandemic are now facing the effects of 40-year high inflation. As a result, the industry is experiencing increased costs of borrowing, volatile input costs, and a trend of consolidation between operators. Historically, most activity in fluid power distribution and manufacturing has been attributed to non-major players. In 2022, roughly 95% and 87% of activity in fluid power was attributed to minority-share operators in distribution and manufacturing respectively. In 2022, the fluid power distribution and manufacturing sectors were **valued collectively at \$57.2B, growing at a CAGR of 2.5%¹**.

Fluid Power Distribution & Manufacturing Revenue¹



External Drivers¹

The Industrial Production Index (IPI) measures the level of output of the manufacturing, mining, and utility sectors, which are the largest markets for fluid power equipment. A rising IPI reflects greater demand for industry activity. IPI levels plummeted in 2020 due to the pandemic, and coupled with supply chain disruptions and business closures, industrial production experienced contraction across sectors.

The IPI is expected to rise in 2023, representing a growth opportunity for the industry. Further, **industrial production levels, downstream demand, and private investment in fluid power equipment are expected to continue expansion through 2028.**

The yield on a 10-year Treasury note is a reflection on interest rates in the economy. Since interest rates reflect the cost of borrowing, low interest rates encourage investment. This includes private investment in industrial equipment, a driver of industry revenue. Conversely, higher interest rates can constrain investment in industrial equipment and industry revenue. The yield on a 10-year Treasury note is expected to increase, posing a potential threat to the industry.

The pandemic brought fluctuations in the price of raw materials (RM). Fluctuations in RM prices such as steel can be passed on to customers through changing prices, a determinant of industry revenue. Rising steel prices reflect rebounding demand from industrial manufacturers, key users of fluid power valves. An increase in steel prices usually benefits fluid power manufacturers, however, **the price of steel is expected to decline in 2023.**

Industry Outlook¹

During the height of the pandemic, prices for materials such as oil, gas, and wood experienced steep increases resulting from supply shortfalls, which led to spending reductions in major industrial markets. This pricing trend has continued to materialize because of geopolitical tensions from the Russian invasion of Ukraine in 2022. However, industry experts believe that pricing will experience a correction over the next five years. **This potential recovery is expected to facilitate renewed spending on industrial materials, which includes fluid power products and capital equipment.**

As the macroeconomy continues to stabilize following the pandemic, downstream markets are expected to grow moderately as lending rates continue to rise. Even with the continued growth of lending rates, manufacturing is poised to exhibit strength, especially in the production of high value-added products and equipment. The domestic manufacturing sector will benefit from the reshoring of some production, resulting from increased wage costs in historically low-cost countries such as China. Overall, the IPI is expected to rise through 2028, stimulating demand for fluid power equipment from manufacturing and mining operators.

Depreciation of the US Dollar, consistent consumer spending and pricing rebounds will support growth of corporate profits. As a result, **corporate profits are expected to grow at a 1.9% CAGR through 2027 as rebounds continue from the pandemic.**

Construction markets are likely to be a growth opportunity for fluid power operators over the next five years, as investment in commercial and nonresidential markets experience expansion. **While construction contractors make up only a small portion of fluid power demand, experts forecast growth in demand for fluid power products in heavy duty equipment.**

Sewage and waterway system upgrades across the US are expected to grow through 2028, creating opportunities for valve manufacturers across the country. As sewage and waterway systems continue to age, demand for new valves will grow as state and local governments focus on upgrading outdated systems. Demand for products such as smart valves, pumps, motors, drives, and other control hardware that improve quality and efficiency will increase as a result. **The US Government will continue to focus on investment for maintaining and repairing water systems, stimulating demand for industry operators through 2028.**

Industry Trends¹

Consolidation across the fluid power distribution industry is expected to persist as workforce growth is expected to slow as demand stabilizes and the market experiences further saturation. Enterprise growth is projected at a CAGR of 0.5% to 2,708 operators* over the next five years. Over the same period, industry employment opportunities are projected at a CAGR of 1.2% to 46,067 positions, indicative of increased production and efficiency across individual operators.

Competition across the fluid power distribution industry is expected to intensify across distributors serving a saturated market. As a result, the most efficient distributors will likely differentiate themselves from competitors through the presence of value-added services. This includes the widening scope of fluid power operators serving as a one-stop-shop for downstream users. Despite growth projections in corporate profits through 2028, **internal competition is poised to dampen some of those gains, leading to profit stagnation over the same period.**

Technology has quickly emerged as a disruptor in the fluid power space, as manufacturers are continually integrating valves with control systems and software. These "smart valves" ensure increased product quality and processes efficiency.

The National Fluid Power Association (NFPA) found that the TTM moving average of shipments for pneumatics, hydraulics, and total fluid power products have continued to grow into 2023. The YTD (as of February 2023) percent change for total fluid power shipments was 13.6%².

M&A Activity³

Since 2021, there have been several acquisitions in the fluid power space. A study of 37 transactions since Q1 2021 and their metrics are provided to the right.

Select Transaction Analysis³

Average Deal Size (\$M)	\$108.30	Millions (USD)
Median	\$42.10	
25% Quartile	\$2.35	
75% Quartile	\$149.00	
Minimum	\$0.25	
Maximum	\$490.68	

Select M&A Transactions³

Date	Target	Target Description	Acquirer	Deal Value (\$ in millions)
5/1/2023	Valin	Distributor of machinery intended to offer automation, filtration, fluid handling, fluid power, heating and process control products and systems for a wide range of high purity and industrial applications.	Graybar	N/A
4/28/2023	Norcan Fluid Power	Manufacturer and distributor of hydraulic, pneumatic, electromechanical, filtration, and lubrication technologies intended for motion and control applications.	Fluid System Components	N/A
12/30/2022	Northwest Swiss-Matic	Manufacturer of industrial, hydraulic and pneumatic products based out of Preston, United Kingdom.	Graham Research	N/A
12/19/2022	Air Hydro Power	Operator of drilling fluids business based in the Middle East.	Houchens Industries	N/A
11/10/2022	American Iron and Alloys	Manufacturer of machinery and parts intended to serve the automotive, medical, defense and fluid power industries.	The C.A. Lawton	N/A
10/31/2022	Bond Fluidaire	Distributor of fluid power intended to serve multiple mobile and industrial industries.	Exotic Automation and Supply	N/A
6/15/2022	Skarda Equipment Company	Operator of a sustainable manufacturing enterprise intended to design and manufacture hydraulic circuits, systems, and components.	Certified Power Solutions	\$15.10
4/6/2022	R&G Fluid Power Group	Manufacturer of elastomeric components and tools that are used in the aerospace, military, biopharma and specialty industrial markets.	BlackRock TCP Capital BDC (NAS: TCPC)	\$110.00
3/22/2022	Hydraquip Hose & Hydraulics	Operator of an industrial fluid power distributor company intended to provide fluid power product and services.	Finning International (TSE: FTT)	\$116.00
1/6/2022	Banford Engineering Products	Provider of on-site mobile hydraulic hose services intended for construction, power systems, transportation, waste management, and manufacturing industries.	APS Industrial	N/A
12/13/2021	Hydraulic Strategies	Manufacturer and distributor of fluid power solutions based in Zaragoza, Spain.	Lifocohydraulics	N/A
9/9/2021	Aldro (Construction and Engineering)	Manufacturer of HVAC equipment based in Wroclaw, Poland.	Desktop Metal (NYS: DM)	N/A
6/2/2021	Denley Hydraulics	Manufacturer and supplier of electrical, automation and instrumentation products catering to the local Tasmanian industry.	SCX Group	N/A
4/1/2021	Fortress Fluidsentry	Provider of metal processing and finishing services intended to serve a variety of industries from fluid power to bearing manufacturing.	Fortress Interlocks	\$0.46
4/1/2021	Q'Max Solutions (Drilling Fluids Business)	Manufacturer of hydraulic valves, control blocks and systems with a focus on the off-highway sector which includes agricultural machinery, construction machinery and conveyor vehicles.	Undisclosed Investors	N/A

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We believe businesses are the economic engine of our society, and that business owners deserve and require a proactive advocate to maximize life changing transactions.

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