



Speaking of Business Management

Acquisition Trends in EMS

The EMS (Electronic Manufacturing Supply) industry's expansion strategy has been dynamic over the past 15 years as companies either grow or collapse. Acquisition is the fastest way for expansion and was done extensively in the 1990s. The type of businesses being acquired is different in today's global marketplace. Companies are being acquired to establish local prototyping locations or add diversification to the EMS service offerings. Building anywhere in the US is now considered "local" to OEMs in the States.

Some tier 1 companies (with over \$2M in revenues) have paid the costly price for acquiring excess high volume capacity in the United States in the prior decade. These acquisitions were made to expand business by buying customer manufacturing facilities. The OEMs were shifting to the outsourcing model and sold their manufacturing capacity with the guarantee of future business for the CMs (contract manufacturers). This seemed good at the time for the CMs because they increased revenues and broadened their customer base quickly. There seemed to be enough business for everyone as the growth plans for the industry was positive. But with the electronic recession at the beginning of our current decade, this excess capacity became a heavy burden and caused companies to close operations. OEM customers were going out of business or cutting back while the high volume was migrating to Asia. This left the large manufacturing centers in the US with too much excess capacity that needed to be shutdown or moved.

Small companies, without a specific technology niche, have suffered or died during the US electronic manufacturing recession. Having a technical niche gives justification for a small business to exist in the States. Specific technology niche examples like:

NPI (New Product Introduction), prototype, electro-optics, flip chip on board, military, medical, or telecom. The general purpose "low-tech" private companies are becoming a thing of the past and have little value to the companies that are making US acquisitions. These companies offered assembly labor only to OEMs that truly need quality prototype and engineering consulting on how to make their products more "production ready".

Companies that wish to expand the numbers of locations in the US can either start a new (green-field) operation or acquire an existing small business in the local market. Acquisition is currently the most popular method of expanding the business base in new geographies. This is largely due to the need to establish relationships with the local customers quickly. Right now there are more business buyers than there are qualified companies for sale. It is more efficient to "buy" customer relationships than to try to pry customers away for the entrenched suppliers. It is also more prudent to use existing staff that have the personal relationships with local customers rather than create a new team and begin a marketing campaign. The only downside is that the acquired company infrastructure will need to change to match the acquiring company's systems and equipment. This is an organizational adjustment that must be kept transparent to the customer base or they will leave during the confusing transition time.

OEMs are focusing on core competencies of product and marketing while leaving the detail design and manufacturing to the EMS companies. Standard manufacturing is becoming a commodity to be outsourced. For the most part, venture capitalists are investing in OEMs not in CMs. They are acquiring

software companies and companies with intellectual property that can be leveraged into significant earnings ratios and ROI.

Successful EMS companies are becoming more vertically integrated to offer additional services to OEM customers under one business structure. In the EMS world, it is cheaper to buy capabilities that to develop new processes or methodologies. Developing new technologies and solutions is a trial and error venture. The lower profit level in the manufacturing industry does not support this kind of risk.



"In the EMS world, it is cheaper to buy capabilities that to develop."

Small entrepreneurial firms take this kind of the risk, for if they are successful in the development, they can reap a reward when selling their company. The largest EMS companies today own design, materials, plastics, optics, PCB, assembly, test, and integration capabilities.

This industry just can not support a large quantity of EMS providers. The profit levels are just too low. Consolidation of some of the tier 2s into the tier 1s seems to be the eventual direction. EMS companies have got to be very lean in all aspects of the business but must provide the ability to coordinate all the different service offerings to the customer in a seamless manner. This is not an easy undertaking, and will certainly separate the top performers from the has-beens.

Gary A. Tanel is an SMT Editorial Advisory Board member, SMTA-Dallas chapter President, and Senior VP of Electronic Manufacturing Services for Associate Equity Group. He is Chairman of the Dallas M&A Forum. (972) 751-0700
GTanel@AssociateEquity.com