Pace Equity Forecast for Mid-Market M&A in 2015

PART 2

INTRODUCTION: Pace Equity is a long-standing and authoritative M&A Boutique advising on M&A and capital fund raising across a wide range of industry sectors in the UK and internationally. Our mid-market M&A forecasts are based largely on our own research and experience and we offer this forecast for information only. We regret we cannot accept responsibility for actions that may be taken based on these forecasts.

The first part of the Pace Equity M&A Forecast was released at the end of January and with this concluding part the analysis of various sectors will continue in order to provide our valued clients and contacts with some useful and insightful information into UK economy and the different sectors that have made it grow so successfully over the past year.

In Part 1 there was a focus on six specific industrial sectors:

- Health Care, Equipment & Services
- Food Producers
- Travel & Leisure
- Energy and Support Services
- Consumer Goods
- Construction & Materials

Within these sectors we saw some promising statistics, trends and figures that have left the team at Pace Equity with a very positive outlook for 2015. If you did not receive a copy of Part 1, please e-mail callumboyce@paceequity.com and we will be pleased to send you a personal copy for your records.

It is now important to move onto Part 2 of the Pace Equity M&A Forecast Report, which will address the following:

- IT and Tech
- Media
- Financials
- Telecommunications
- General Industrials and Automotive
- Industrial Engineering
- Aerospace & Defence

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IT and Tech

Some of the biggest and most widely publicised M&A deals appeared in the IT and Tech sector. WhatsApp sale to Facebook, NestLabs sale to Google and the acquisition of Beats by Apple were three of the most talked about deals in the past year, illustrating that there is significant movement in this sector.

IT and Tech saw growth in both the technology subsector and software and computer services throughout 2014. Software and Computer Services for example grew by 4.95%. Across the technology sector worldwide, deal making is up 2.5% after doubling in 2013, clearly showing that this is a sector that has recovered well and is now experiencing further growth.

One of the major reasons behind this growth is the developing online presence of a large percentage of companies. Whether it be retailers, food producers or service businesses, it is now imperative to have an online presence. However this is no longer enough and there is the growing need to have a digital presence on social media. Added to online growth presence is the rapidly expanding use of cloud computing. Although not an innovation for 2015 there is an increasing trends of more and more companies, mostly in the small/mid market that are moving towards cloud based systems.

With these areas of growth, companies are presented with major threats of hacking and issues of cyber security. This is set to be one of the biggest trends in the IT and Tech industry in 2015. Companies need to protect their data and if they deal with customers online then their customers' data should be of paramount importance. M&A involving companies offering cybersecurity services or software is set to grow significantly in 2015.

Both a feature of the IT and Tech industry as well as the Telecommunications sector is the development of the wearables market. This is set to be a major trend of 2015 with the imminent release of the Apple Watch and the growing interest in Smart glasses and VR headsets. Another area of expanding interest that couples with the wearable market is health and fitness tech. These sectors present an interesting foundation for M&A deals. Consolidation of smaller companies, which focus on development or analytics within the wearables and fitness tech areas, will be a definite feature. Larger competitors, who are looking to streamline and maintain their competitive edge in this market, will play a big part in 2015 M&A deals.

Media

The media sector is one that has changed a lot during 2014, with different trends depicting the way this industry operates. The industry saw an overall increase of 2.4% as well as growth in the P/E ratio. Within the media sector, digital has been the dominant theme.

Digital advertising is growing rapidly and staring to seriously rival the traditions of TV advertising. Digital advertising, worth £7.97bn in 2015, will be the dominant advertising platform within the next 3 years. This brings in one of the biggest questions in relation to the media industry. How to monetise the digital advertising revolution? Companies that show an

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understanding and a drive to capitalise on this revolution will find themselves with a clear advantage.

Away from digital advertising is the role of video and on demand services. These mediums have been big in 2014 and the predictions are for this trend to continue. Video will be an important part of a brands strategy to engage and connect with customers and clients. A key part of a brands strategy is being able to successfully push their message; this will be done by video in 2015. Experts at Deloitte predict that short videos will bring in revenues of over £3 billion. Therefore companies that provide a high quality creative video service will be in high demand in 2015.

This brings us on to the state of M&A in 2015 within this sector. Like we have seen with the IT and Tech sector there will be a trend of larger companies acquiring smaller competitors. The focus of these acquisitions is likely to be on companies that specialise in advertising and social media. The ability to integrate these smaller specialists into a larger company is an attractive prospect as it allows the ability to build loyal audiences with less effort and without outsourcing. Look out for M&A deals with this strategy as a focus. In the UK we have seen some significant M&A deals within the television market, with Viacom completing its acquisition of Channel 5 for a reported £450m and Sony's acquisition of CSC for £107m.

Security can not be ignored with these new developments and again is another aspect that the banking sector must watch out for.

Financials

With the improvement and steady growth of the UK economy set to continue in 2015, the Financials industry will experience a similar year of growth. 2014 was a good year for financial services with Life Insurance/Assurance growing by 12.59%, Nonlife Insurance up 5.08% and Real Estate Investment Trusts increasing by a substantial 20.31%. These figures present a picture of solid financial growth but what have these companies got to do in order to maintain this growth?

One of the key areas of development is technology. This is particularly important within the insurance sector which has often been slow to modernise. One of the key technological advances in 2015 will be the wider use of telematics. Some insurers are already using it within the automotive industry and this is set to continue, increase and expand. One new area within telematics will be its use within the home appliance market. This will allow insurance companies to track the state of boilers and fridges and sell maintenance policies. Mario Greco, chief executive of Generali, Europe's third-largest insurance group by premiums told the FT, "Insurance, for too many, has been a mandatory business; Insurance has to transform itself — to one where customers want it."

Technology is also set to play an important role in the development of banking in 2015. Customers want access to faster and easier payment as well as a more streamlined process for transferring money and accessing their accounts. However security is a substantive issue and the banking sector must provide the right levels of reassurance to customers. M&A in this area will accelerate.

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Added to this, in the UK, the Payment Systems Regulator will be granted new status as an economic regulator in April 2015. It currently operates systems such as LINK, CHAPS and Bacs, but its influence on the online and mobile payments spaces is set to increase. There is a lot to look out for in the financial sector in 2015 so keep an eye on how the market responds to these technological demands.

Telecommunications

2014 saw the value of M&A deals at a height not seen since before the recession, however the volume of deals was down. Fewer deals do not always reflect a poorly performing market. M&A is back on the agenda for telecommunications companies in 2015. One reason for this slip in growth development is an increase of cheaper network providers. Added to this there have been changes to regulation. An example would be the new data roaming caps that have been applied across all EU countries. These changes have left telecoms companies with weaker balance sheets than they are used to. However 2015 is set to regenerate this industry and M&A is at the forefront of the upward trend.

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One key affect that M&A will play in 2015 is that it will allow mobile operators to build a more loyal customer base by consolidating their mobile networks with internet, home phone and on demand TV services. BT is one of the companies who have been most active about this development with their proposed acquisition of EE for £12.5bn.

As Jeroen Hoencamp said to the FT, "2015 is going to be a busy year, with many changes on the cards for the telecoms industry. We're going to see some major consolidation, some major upheavals and some great opportunities". Telecoms companies want a loyal and steady customer base and consolidation through M&A is one of the key ways of achieving this, so be prepared for telecoms deals to surge this year.

General Industrial and Automotive

2014 has returned the general industrial sector to a more stable level of M&A activity. Confidence has been restored and there has been a good level of deals in the many sub-sectors that make up this industry. Within this sector there has also been an increase in the interest from private equity funds, which in turn has attracted the attention of CEOs.

Over the past few years the UK the automotive industry has not been one that has flourished through M&A, however we believe with the general rise in the UK economy and with consumers returning slowly to the market, the industry is likely to see more M&A activity in 2015. Jaguar Land Rover's announcement that the new Discovery Sport is set to have a large production line set up in the UK will almost certainly activate M&A interest from the mid-sized JLR suppliers. In general, we are quietly bullish about M&A in this industry this year.

Aside from manufacturing talk it is also important to look at general trends and themes in the automotive sector. Alternative fuels has long been a discussion, however 2015 is the year that these ideas begin to appear on the forecourt. Hydrogen fuel sales will be a big theme and the debate around hydrogen or electric is one that has already begun.

New technology as we have seen in many other sectors is playing a huge part in the direction of these industries. M&A deals will look to capitalise on this new technology and companies that are focusing on these new fuels or other green technology will see themselves as targets for acquisitions. Added to this, the drop in oil prices has had an effect on car sales as more people are feeling the benefits of driving and if the low price of oil continues, this trend is surely set to grow.

Industrial Engineering

With industrial engineering experiencing a slight dip in the early part of 2014 there were bearish sentiments for some months. However, the final six months of 2014 saw a return to a more bullish environment and M&A deals were back on the agenda. Law firm Irwin Mitchell says that manufacturers in the UK were the target of 236 deals during the third quarter of 2014. This takes the total number of deals to 619 – 28% more than the same period in 2013. Due to good debt markets, healthy activity across many sub-sectors and a more positive outlook among industry participants, M&A activity is looking promising for 2015.

Chris Rawstron, partner and head of Corporate & Commercial at Irwin Mitchell said, “There was an increase in the number of PE-backed manufacturing deals in 2014 and this continued in the last three months with almost 20% of transactions being funded via private equity”.

In a survey from Deloitte, 94% respondents from this sector said that they were set to be acquisitive in 2015, with 54% describing themselves as very acquisitive. As with the General Industrial sector above, there is more confidence around the availability of debt and the confidence from private equity funds to fuel these potential deals. Private equity backed deals have had a big influence on the sector and the Business Growth Fund has already announced a host of new investment deals in the first 6 weeks of 2015.

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One of the notable deals in this industry was the £60m acquisition of Public Safety Equipment International (PSE) by US based ECCO Group. The company that manufactures and installs lighting systems in emergency vehicles, including military and government organisations enjoys turnover of around £105m.

Aerospace and Defence

The Aerospace and Defence sector has experienced mixed fortunes in recent years. With the constraints on spending during the economic crisis in Western markets and particularly in the UK and US, there has been an overall decrease in the market. However it is not all bad news. Long running projects have generally continued and maintenance programmes cannot be curtailed for too long. Consolidation and cost savings will be a key feature of the industry going forward. We anticipate that M&A in 2015 will focus mainly around these two areas, although technology-led acquisitions will continue to play a prominent role.

One area that is showing significant growth is the manufacture and sale of drones. This has been solid and growing business over the last few years and with the transition from the defence sector to the mass market their potential is potentially set for explosive growth. Drone manufacturing has also spawned major advancements in GPS technology, micro avionics and microprocessors.

The commercial aerospace sector has enjoyed good growth in recent years and is set to continue that trend. One of the largest deals seen recently has been the £3bn acquisition of UK-based jet manufacture Firth Rixson by Alcoa of the USA

Recently, larger airlines have been upgrading their fleets in significant numbers and the smaller airlines will have to follow if they wish to stay competitive. This is good news for all areas of aerospace manufacturing. Reports state that there is an anticipated 25,000 to 35,000 of new commercial aircraft purchases over the next 20 years.

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This demand has created pressure within the industry as production rates have had to build to meet demand. This presents opportunities for consolidation amongst the smaller manufacturers, but also creates good opportunities for M&A amongst suppliers and service providers.

We would like to thank you for your interest in reading this Part 2 of the Pace Equity Mid-Market M&A Report for 2015. We hope that it has been informative and interesting for both you and your business.

If you would like to contact Pace Equity to explore opportunities for your own company please e-mail callumboyce@paceequity.com or call one of the team (see www.paceequity.com/team) on 01491 577889

Pace Equity is one of the UK's longest standing and most authoritative M&A Boutiques having been in business for 26 years. We offer a full-advisory service specialising in mid-market private companies. We advise companies and Boards of directors on Mergers, Acquisitions, Company and Share Sales, Capital Fund Raising, Valuations, Market Intelligence and Growth Strategies.

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