MOORE Kingston Smith

UK MANUFACTURING SECTOR REMAINS RESILIENT DESPITE CHALLENGING 2020

A review of investment in the manufacturing sector in 2020

Manufacturing is big business in the UK, accounting for £19 billion of the country's output, 53% of its total exports, and employing 2.7 million people. The significance of the sector hasn't gone unnoticed by investors, who have long been hungry to be part of its success story. While the pandemic took its toll on the sector, a strong year-end in the UK for manufacturing investments suggests investor interest remains strong, according to research from Moore Kingston Smith.

The Q4 data belies underlying uncertainty – while the world has suffered a shock by way of the Coronavirus, British companies in all sectors had the added challenge of preparing for a new normal as the countdown clock ticked towards the end of the Brexit transition period, forcing a new trading relationship – the details of which weren't known until 24 December – with the European Union, the UK's largest export market. The protracted negotiations made business planning extraordinarily challenging in 2020. It may even be that the Q4 upturn in British manufacturing businesses was a rush to beat a potential no-deal Brexit. This lack of clarity lingered for most of the year, and with nearly half of UK manufactured goods exported to the EU in 2020, a positive post-Brexit trading agreement was key.

The confluence of these two significant events in 2020 impacted the British economy, with the manufacturing sector expected to record a 12% drop in output for the year. While certain subsectors are resilient and even growing, manufacturing growth forecasts for 2021 are just 2.7%, down from a previous forecast of over 5%. The figures are particularly sobering if you consider British manufacturing before the pandemic was operating below pre-Global Financial Crisis levels despite a strong couple of years leading up to Coronavirus.

That 2020 was a year of two halves is reflected in the Purchasing Managers' Index (PMI), an economic indicator based on a survey of manufacturers, which soared from a 7.5-year low to a 37-month high during the course of the year. 2020 started with the PMI down to 45.6, the lowest since July 2012. This is likely because a heightened number of market participants had been citing uncertainty around Brexit as a top concern since mid-2019. There was a reduction of new orders as well as Brexit safety stocks, which led to the sharpest output fall since 2012. But this turned a corner during the year, with a perceived rush to beat Brexit seemingly trumping pandemic fears, to recover to a 37-month high of 57.5 in December 2020.

These 12 points are significant since a score below 50 suggests most manufacturers are contracting. The PMI may have been boosted by businesses anticipating purchases in advance of the end of the Brexit transition period, though the end of 2020 saw supply-chain delays, including shortages of raw materials and port hold-ups – caused by the pandemic and Brexit.

CONTACT US

If you're an ambitious manufacturing business with revenues of at least £1 million and are looking to scale up or exit, get in touch for an initial discussion. We can work together to assess the best action and then assist with finding the right partner or acquirer. Contact us to find out more about our raising finance and M&A services.

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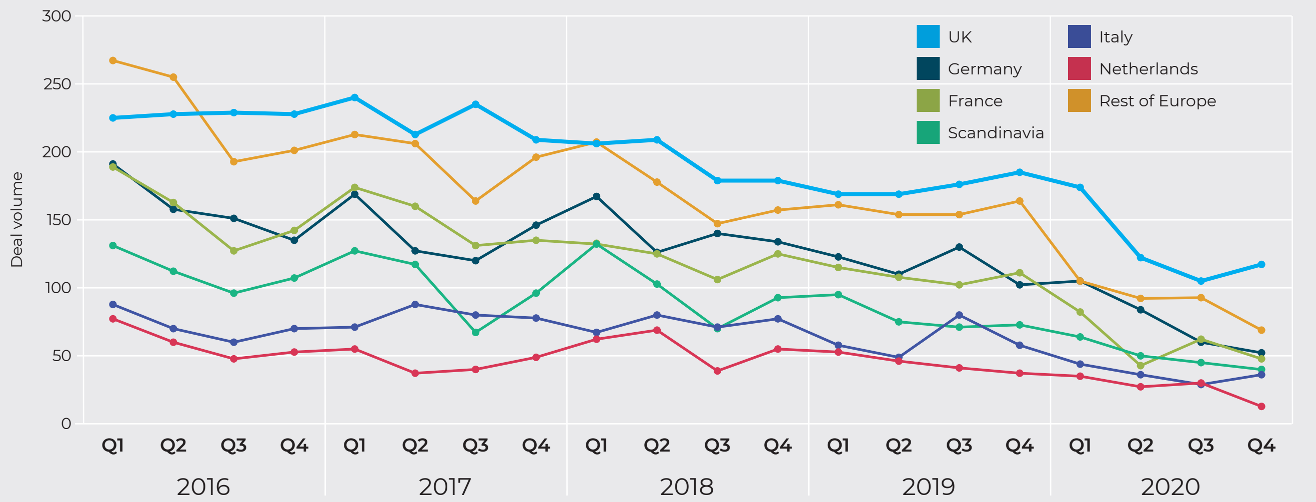
UK MANUFACTURING REMAINS RESILIENT

DEAL VOLUME



The number of investments into manufacturing businesses has been on a bumpy decline for most of the UK and the EU over the last few years. The UK has achieved the highest investment levels in the last few years, and even recorded a gentle increase at the end of 2019 before falling sharply as the pandemic bit. The end of 2020 saw an encouraging upturn – the steepest quarterly increase since Q2 2017.

It is important to note that the apparent increase will be masking variations among subsectors. For example, manufacturers of components for electronics may have been in higher demand as people pivoted to ongoing remote working and waves of school closures.

Manufacturers of supplies to the pharma industry as well as packaging makers which proved necessary for ramped up distribution, may have seen new opportunities. These boons will have been very different to the paralysing situation other manufacturers found themselves in, such as automotive and airline parts makers and those involved in supplying consumer-facing firms.

It remains to be seen whether the UK's end-2020 upturn was a blip in the race to beat a potential no-deal Brexit, or a sign of renewed confidence in investments in the sector.

INSIGHTS FROM AN INVESTOR:
DAVID TURNER, INVESTMENT DIRECTOR AT FORESIGHT GROUP

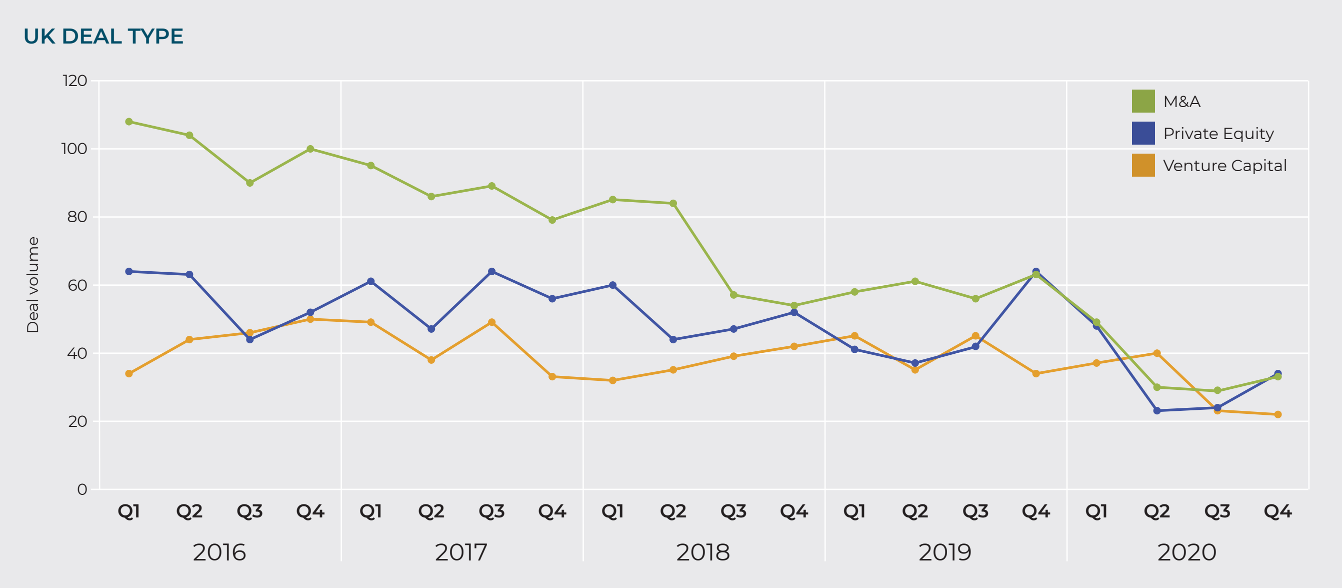
With challenge comes opportunity, and nowhere is this truer than in the UK specialist manufacturing segment. "We are drawn to UK manufacturing as much of it has a high degree of specialism and unique intellectual property, enabling many of these businesses to have a real international presence and compete on a global scale," says David Turner, Investment Director at Foresight Group.

This, he explains, is why Foresight is drawn to invest in the sector, with its recent investment illustrating the global reach a specialist British manufacturer can have: in December, Foresight provided £4 million of equity release and growth capital into MR Machine Knives, a Sheffield-based business which exports 80% of its products into 50 countries.

The deal brings to 16 the number of manufacturing businesses in Foresight's portfolio. "Most are specialist operators with a leading position in a market niche, and so the majority of our investments have been resilient through Covid as well as Brexit." Naturally there were outliers such as those focused on the aviation and advertising sectors, which found the year challenging, while others which provide mission-critical products – such as the healthcare sector – saw increased demand.

Looking ahead, David sees opportunity in bringing firms' supply bases onto the mainland. "The UK has some high-quality manufacturing businesses which have responded well to the challenges of 2020. The EU was a major trading partner and that lack of clarity caused uncertainty with customers and suppliers. While progress is ongoing, it is moving and most of our portfolio have responded positively."

PRIVATE EQUITY LEADS Q4 MANUFACTURING DEAL RECOVERY IN UK



Manufacturing deals in the UK saw a sharp decline between Q1 and Q2 as the pandemic made its way to the UK. This caused investors – corporate and financial alike – to go into defensive mode, with the former looking to protect existing revenues and the latter nurturing portfolios. This steep fall continued in Q2 before stabilising in Q3, as many firms will have started creating paths back to growth and planning investment as part of that, whether through fresh opportunities or resuming those that had been put on hold earlier in the year.

The final months of 2020 saw the number of private equity investments into manufacturing increase. This renewed focus on deal doing will have been a confluence of myriad factors: a hunger to deploy record sums of capital, causing some assets go for very competitive valuations; a gentle slide in the value of the sterling as the end of the year saw the UK dance dangerously close to a no-deal Brexit; a desire to add value to existing portfolios through accretive M&A; and increased opportunities to do so as valuations were impacted for certain companies.

CASE STUDY: TRUE LENS

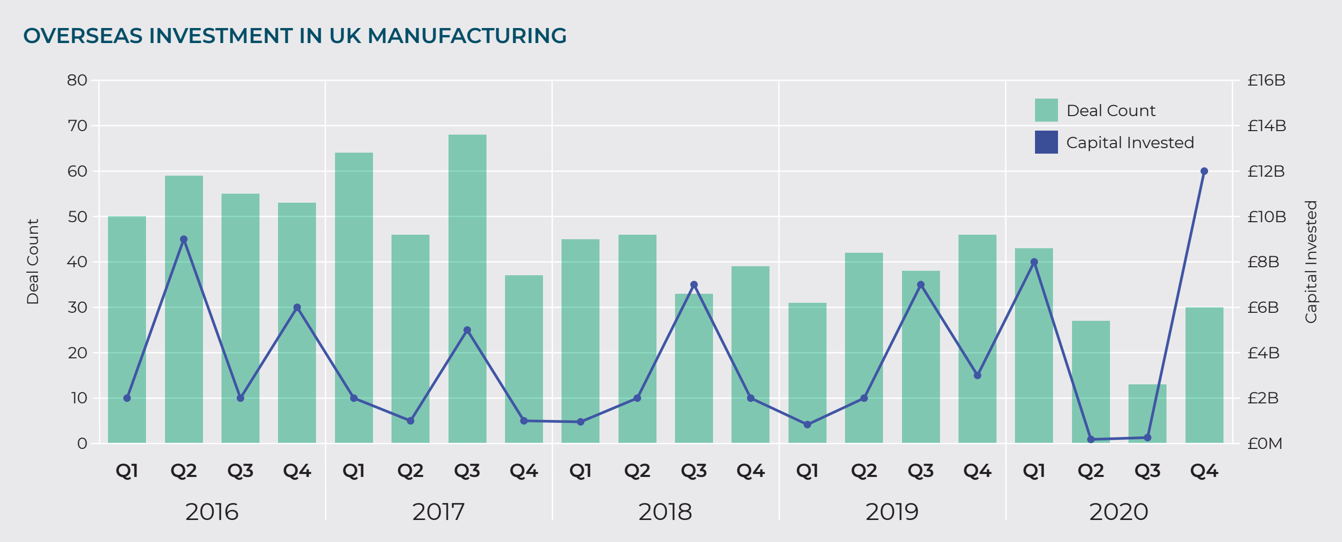
True Lens Services Limited (TLS) is a specialist provider of lens rehousing and global market leader for innovation and servicing camera lenses. While 2020 caused a lot of businesses to re-assess strategies, TLS was minimally impacted, remaining fully operational throughout 2020 following a brief pause to ensure safe working practices at the height of lockdown. In fact, having provided services to the film industry for 19 years, 2020 actually saw TLS start a new and exciting chapter in its own history in September when it carved itself out of Procam Television, itself looking to focus more on core activities following a turbulent 2020.

The transaction was supported by Foresight, which also provided additional capital to support TLS's product development and international growth. David sits on the board and praises the firm's resilience: "True Lens performed strongly as demand for its core services remained strong. They operate on an international basis, so as lockdown shifted globally in 2020, they were able to adapt to demand from different regions."

TLS is already recognised globally for its lens innovation, and recently launched a new range of high-speed full-frame cine lenses (VEGA), which are ideal for low-light environments or where a narrow depth of field is required. Part of TLS's near-term plans includes investment in its UK manufacturing capacity and further international expansion in North America and Asia for its VEGA range.

"As an independent entity with financial backing, TLS now has that freedom to accelerate the rollout of its VEGA product range. We've strengthened the team with senior hires to support the existing MD, and are improving the manufacturing capacity and production to launch it in the UK, US and Asia." The positive inertia already in place suggests it'll be a major part of TLS's business within three years. "The addition of manufactured products to its existing lens servicing is a natural next step in the company's evolution," David enthuses.

STRONG FOREIGN INVESTMENT IN UK MANUFACTURING



Volume more than doubled between Q3 and Q4, with 30 deals recorded in the final three months of the year, up from just 13 in Q3.

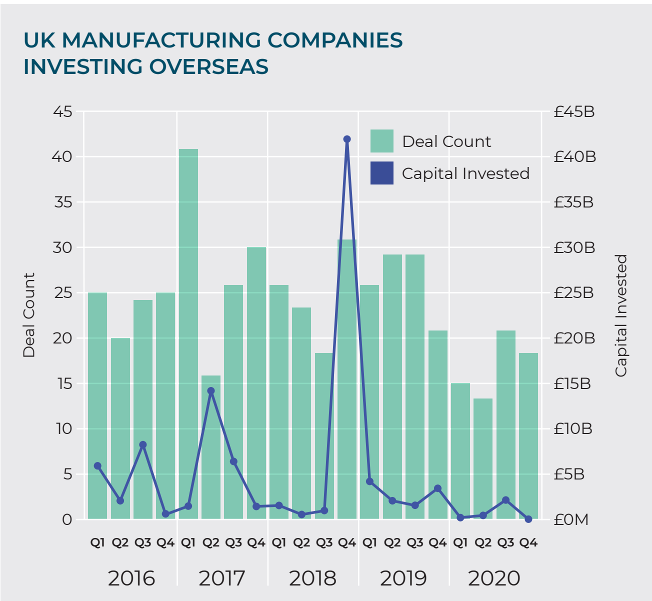
Value also soared, with Pfizer's acquisition of Hatfield-based Mylan for $12 billion completing in November. The deal, announced in June, highlights the nuances in subsectors, with pharmaceutical businesses one of the precious few areas to see heightened demand in 2020 – from both customers and therefore investors.

"Overseas investment into UK manufacturing businesses may have boosted increased opportunity. The UK government's ambition to 'level up' is catalysing a swathe of manufacturing projects, not least the behemoth infrastructure projects providing connectivity between the North and South. Additionally, the government is currently undertaking an inquiry for post-pandemic economic growth[1] which could lead to more opportunity in various sectors, with manufacturing likely to feature highly," says Dan Martine, Head of Manufacturing and Distribution at Moore Kingston Smith

If we look to 2016, we see a Brexit pause followed by a post-referendum 'recovery' and even surge – likely a combination of pent-up demand that paused, as well as heightened foreign interest as Brexit catalysed a dip in sterling's value, and so UK assets became relatively cheaper to foreign buyers.

A similar wait-and-see approach by foreign investors looking at UK targets may have catalysed a lull in Q2 and Q3 followed by a surge in Q4 as investors sought to take advantage of a dip in sterling as well as agree deals before the end of the Brexit transition period.

UK INVESTING IN MANUFACTURING OVERSEAS



The second half of 2020 was stronger than the first for UK firms buying overseas manufacturing assets, led by a strong Q3. Hertfordshire-based Mylan acquired the European thrombosis business of Aspen in September for €642 million, following on from the announcement that Mylan itself would be combined with Pfizer's Upjohn business in a deal worth over £9 billion.

The majority of investment capital from the UK going into overseas manufacturing businesses heads to the US, and 2020 was no exception, with the country accounting for a larger share in Q4 than in previous quarters.

The EU is the second most-favoured spot for British investment, likely owing to proximity as well as being part of the bloc for over four decades. "Investing in businesses abroad can be very rewarding, not least because of the enhanced geographic footprint it can bring. But specialist skills are required for success, including in Europe now the UK has left the EU, making local advisers key," explains Marc Fecher, Partner at Moore Kingston Smith. He speaks from experience as a Director of Northwood, the market leading hygienic tissue manufacturing business, which acquired the Spanish Dicepa in September 2019. The business included a paper machine manufacturing recycled paper used in hand towels, and an operation manufacturing table top, napkins and facemasks for retailers and distributors. This acquisition secured both raw materials for it specialist hand towel operation in the UK and products for the wider Northwood Group as well as giving Northwood a base of operations for access into the markets of Spain and mainland Europe.

LOOKING AHEAD

The year 2020 ended positively for UK manufacturing, with deal activity and sentiment both up: December brought with it an agreement between London and Brussels on the future trading relationship between the UK and the EU, as well as a long-awaited vaccine roll-out, giving hope of a light at the end of a long, dark tunnel. As a result, it may be that 2021 sees a continuation of deals in the manufacturing sector. Additionally, a government-led push to kickstart the economy back to growth may bring an opportunity for manufacturing businesses to build back better after Coronavirus and after Brexit, both for existing businesses as well as new ones.

The detrimental impact of the Coronavirus as well as Brexit uncertainty in 2020 may mean a shake-out in the manufacturing sector in 2021. Businesses which survive will be perceived as high quality, and this reduced supply combined with ongoing demand will put upward pressure on valuations of those businesses.

Deals that take place will be driven by changes to these companies' circumstances over the last year, which have catalysed a shift from long-term planning to shorter-term as agility is prioritised. This in turn may polarise the market and drive exit activity: thriving firms have never been more valuable and so may be tempted by a sale, while those in survival mode may be relieved to find buyers. Both may be considering the announced hike in corporation tax for larger businesses and trickier EU exports in post-2020 Britain. "Where people have the choice to invest and grow their businesses or exit for a profit, they'll exit. We'll see a continuation of that in 2021, but many are at risk of forfeiting some value as they prioritise certainty over maximising value," Marc points out. "Changes in market dynamics and the economic cycle mean the only way to get a clear idea of valuation is by speaking with people in the market to see what today's prices are. It's moving away from theoretical and into the real world."

Today's reality is valuable for many. Corporates remain hungry for manufacturing businesses as they look to accelerate growth through accretive acquisitions, while financial investors may look to M&A to add value to platforms. "Buyers are paying a premium for assets, and this is especially the case where strategics are paying up for corporate synergies, or even private equity firms with unprecedented sums of capital to invest into revenue-generating assets. To maximise value, businesses must be adequately prepared for the fundraising or sale process – meaning data gathering, HR, environmental issues are well presented – and that the right buyer or investor universe its targeted at this time of heightened valuations."

1 https://committees.parliament.uk/work/473/postpandemic-economic-growth-levelling-up-local-and-regional-structures-and-the-delivery-of-economic-growth/

METHODOLOGY

Moore Kingston Smith has analysed transactions by European and UK-based companies that involve the issue of less than 50% of equity share capital to third parties and funds raised of between £1 million and £20 million. Accordingly, these numbers do not include senior debt and mezzanine debt fund raisings and smaller fund raisings by companies and start-up funding unless more than £1 million is raised. Start-up funding is generally significantly less than this amount.

The research aims to capture all transactions by European and UK companies that fall within the criteria. Inevitably there will be transactions that have taken place but have not been captured. The research is based on data extracted from Pitchbook.