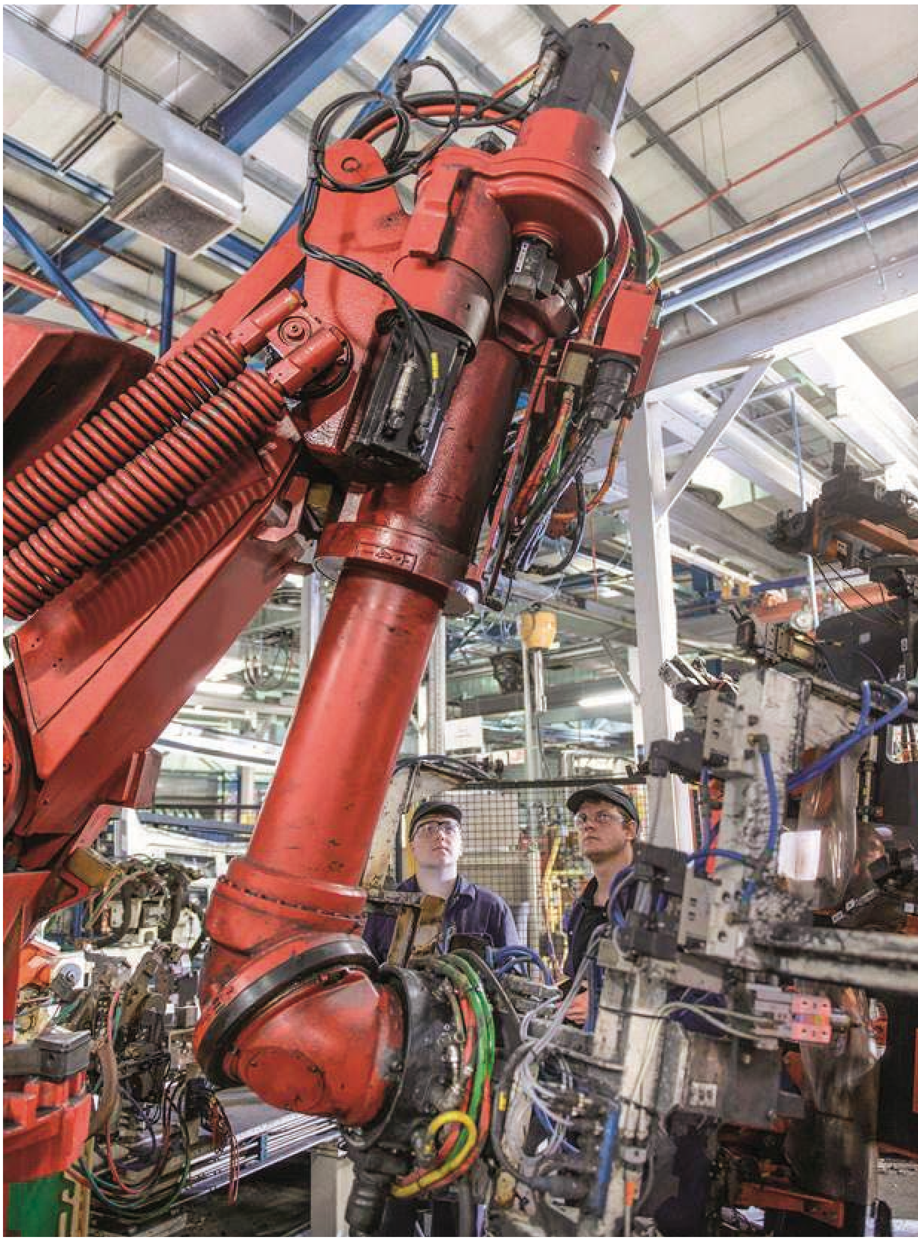
Manufacturing and Industrials M&A Predictions
Optimism Building



Spring 2014

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Foreword

Welcome to the third edition of Deloitte's "Manufacturing and Industrials sector: Our M&A Predictions", which focuses on key trends in our sectors as we approach Summer 2014.

The survey takes place against the backdrop of an improving economic picture in the UK, which has driven an increase in positive sentiment towards M&A since the Autumn.

In this edition we have sought to examine the 18 month trend by mapping responses against our Spring and Autumn 2013 editions, and thereby draw out some of the themes from the last year. Key questions addressed in this publication include: "How have the key drivers of M&A activity changed in the last 12 months?, Have corporates changed their success criteria for M&A?, Do JVs add value to a business?" With this last question in mind, we have also included in our survey questions on experience of joint ventures, in order to understand whether those who have been involved in JVs see them as a valuable addition to the overall business or whether the challenges outweigh the benefits.

Our results are consistent with the Deloitte M&A Index and the increasingly positive sentiment that we see in other commentary and surveys, including Deloitte's Q1 2014 CFO survey and UK Futures series. Deloitte's M&A Index, covering all sectors, forecasts this strong resurgence to continue, and by the end of H1 2014 we expect global deal volumes to reach 15,700, a 10 per cent increase on H1 2013.

We would like to thank all those who kindly took the time to share their thoughts and views of the current market.

We hope you enjoy the read!

The M&A Manufacturing and Industrials team

Key highlights

The majority of our respondents continue to anticipate an increase in M&A activity in the next 12 months, with 73 per cent expecting more activity. This reflects the continued optimism for the sector's financial prospects expressed by 63 per cent of those we surveyed.

A significant majority (69 per cent) of respondents continue to describe themselves as acquisitive. In addition, since our Autumn 2013 survey, there has been an increase in focus on managing existing portfolios, including consideration of divestments.

One of the most significant trends is the return of private equity to the industry: 44 per cent cited this as a primary driver of M&A for the coming 12 months, up from 12 per cent in Spring 2013, while 44 per cent also identified private equity owned businesses as a primary source of target businesses, up from 28 per cent last Autumn.

Experience with joint ventures was mixed, however our respondents were, on balance, positive about their experience of working with joint ventures, whilst cautioning on the importance of documentation and governance.

So overall, what do we think?

We have seen a steady improvement in sentiment around prospects for M&A activity since our first survey in Spring 2013, and are beginning to see this translate into increasing deal volumes. We believe this will increase as we move into the second half of 2014. We also anticipate a focus on maximising the value of existing assets, either through divestments and portfolio rationalisation or expansion into adjacent products and services.

Whilst predictions for 2014 can be made at a broad sector level, it is also important to recognise that there are significant subsector trends. Accordingly, our experts have provided us with their thoughts on what the future holds within a number of these subsectors. Notwithstanding specific industry themes, the overall mood remains optimistic, and we expect to see a steady increase in activity over the coming months.

At a glance

73% of respondents are expecting increased M&A activity in the next 12 months.

69% describe themselves as acquisitive.

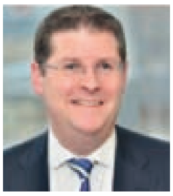
69% stated that they are likely to enter a new joint venture in the near future.

44% believe the return of private equity will be a key driver of M&A activity in the next 12 months.

63% are optimistic for the sector's financial prospects in the next 12 months.

75% of respondents with experience of joint ventures said they had been successful.

Our view



Ross James
Partner, Corporate Finance Transaction Services
Corporate Finance Manufacturing and Industrials Lead

"We are seeing a continuing improvement in sentiment, both regarding the broader economic recovery and prospects for M&A activity. It is taking time for the renewed confidence to impact on announced transaction volumes". Ross anticipates that "the manufacturing and industrials sector will see an uptick in M&A volumes in 2014, driven by improving confidence and increasingly expansionary strategies, as well as the continued good availability of finance, be it from cash on balance sheets or bank lending".

Mark Adams
Partner, Corporate Finance Advisory
Industrials and UK Industry Leader for Chemicals

Mark Adams, our CFA industrials partner and UK industry lead for chemicals notes that "whilst there has been a small decline in actual chemical transactions in Q1 2014, compared with Q4 2013, year on year volumes are higher. Looking ahead to the rest of 2014 the deal pipeline looks healthy with further portfolio realignment and consolidation expected as companies continue to focus on their core growth opportunities".

Nick Wood
Director, Corporate Finance Advisory
UK Industry Leader for Paper, Pulp and Packaging

Nick Wood, our Printing Paper and Packaging ("PPP") UK industry lead notes that "the packaging sector has seen a continued increase in M&A activity over the past two years. The first quarter of 2014 has seen this trend continue, with M&A volumes 37 percent higher over the same period last year. However, there remains a lack of quality deals around and this imbalance with demand, together with a degree of froth generated in the public markets has resulted in an increase in deal multiples being achieved. We expect to see this level of activity increase over the remainder of 2014, particularly in Europe where the market remains relatively fragmented".

Pauline Biddle
Partner, Corporate Finance Transaction Services
UK Aerospace & Defence M&A Industry Lead

Pauline Biddle, our UK Aerospace & Defence ("A&D") M&A industry lead, notes that "commercial aerospace transactions continue to drive both volumes and values within the A&D space, whilst M&A within defence is starting to show signs of life driven by a re-aligning of portfolios to address the reduced government spending levels." Pauline anticipates that "the next six months is likely to see a continuation of this trend, as supply chain challenges are addressed within the commercial aerospace sector and there is an ongoing focus on margin improvements in both Aerospace and Defence that will drive consolidation".

Joint ventures: partnering for growth

Joint ventures

Joint Ventures (JVs) are a recurring feature for manufacturing businesses, whether driven by the enhanced potential for cost efficiencies, the need for a local partner in key growth markets, or enhancing collaboration between existing industry players. They present unique challenges, and we have combined thoughts and comments from our survey responses with information from client discussions and our own observations on how joint ventures arrangements work in practice, to draw out some key themes.

Set out below are the key messages we have distilled.

Key reasons for operating via JV arrangements

As you would expect, in practice there are many different reasons for operating JVs. Responses to our survey (where the participants could choose from a limited number of specific answers) indicated that the JV partner's knowledge of the local geography is by far the most common reason for setting up a JV, which ties well with the broader survey view that expansion into emerging markets is a key driver of M&A.

The survey also highlighted that many businesses enter JV arrangements in anticipation of moving to full ownership at a later date. However, what also came out of our discussions were more specific examples including building closer customer relationships, sourcing components as efficiently as possible, and fostering collaboration between JV partners while retaining ownership of sensitive IP or technology.

Challenges encountered when setting up and operating JVs

Negotiation of exit options and then managing the exit itself without harming the ongoing operations of the JV or its partners appears to be one of the most significant challenges in JV set up and operation. Given the popularity of JV arrangements as a route to full ownership, this stacks up.

The ability (or not) to properly oversee the running of the JV was also identified by survey respondents as a challenge, and the need to set up a solid monitoring system is one of the key learning experiences. In particular where the venture involves more than two partners, coming to an agreement over running and monitoring a JV can prove significantly more challenging, for obvious reasons.

Valuation is a key area of debate where the JV partners contribute assets rather than purely capital.

While negotiating the JV agreement is obviously key, participants highlighted that in many cases the ancillary agreements are just as important. For example, customer or supplier contracts between the JV and either one or all of the JV partners need to be watertight to properly manage potential conflicts of interest.

Pros and cons of establishing JVs

Views on the success or failure of JVs appear quite polarised where only a few JVs have been experienced. Where an organisation has a larger number of JVs or the respondent has more experience of JVs generally, their view on balance was that JVs are value accretive. Interestingly though, a number of respondents commented in terms of "case by case" and "positive, in the long run" and "some very positive, some very negative", which fits with the high number of responses indicating that identification of an appropriate JV partner is a key challenge to setting up a JV in the first place.

One area which is often underestimated is the time commitment required of senior management resource. It's not just attending board meetings, but critically also reviewing financials, maintaining relationships with local management and staying in touch with issues on the ground.

Advice to a business contemplating establishing a JV

We heard that having a "reasonable" business case for a JV is very important. Whilst business cases are sometimes too optimistic, they are also sometimes too cautious, as JV management seek to manage their position.

There must also be a clear strategy for the JV, especially around the exit plan. As above, having a strong working relationship with the JV partner can mean the difference between success and failure.

Overall, we expect Joint Ventures to continue to be an important part of the corporate deal landscape. There are clear strategic reasons for such arrangements, and they can work very effectively to deliver corporate objectives. At the same time, they are invariably challenging to implement successfully, as the mixed feedback set out above illustrates. The key priorities emerging from our research are investment of adequate management time, clarity of vision and business case, and clear alignment of the JV governance and agreements to this.

Our M&A predictions

We asked our panel of CEOs, CFOs and M&A professionals in Industrial and Manufacturing businesses questions covering the current economic environment, deal drivers, valuations and key themes of successful deals and re-financings.

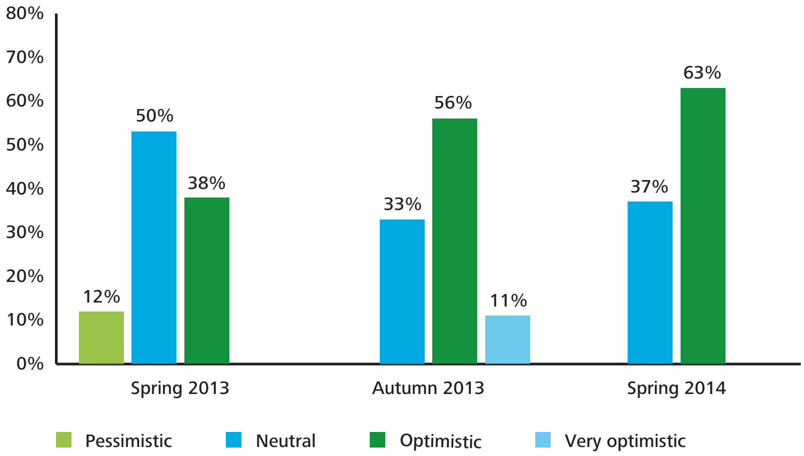
The M&A environment

The responses from our Spring 2014 Manufacturing and Industrials survey reflect continued optimism from Autumn 2013 and a widespread expectation of an increase in M&A activity.

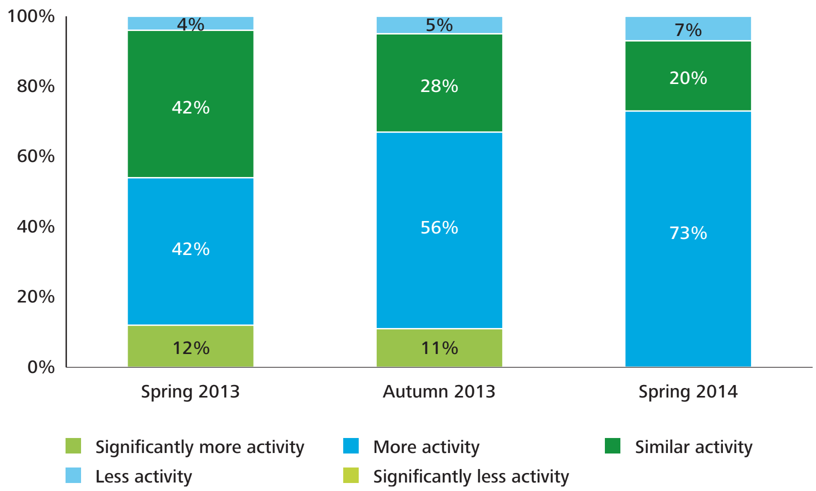
The vast majority of respondents remain optimistic for the sector's financial prospects.

As seen in the Autumn, none of our respondents were pessimistic.

How do you feel about the financial prospects for your sector in the next 12 months?



How do you feel about M&A activity for your sector in the next 12 months?

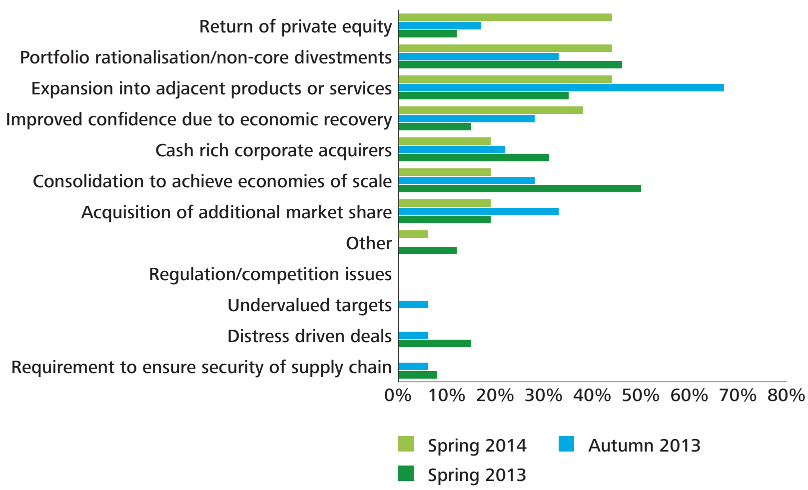


Our survey participants overwhelmingly expect more M&A activity. This is as expected and in line with other recent surveys, including Deloitte's M&A Index.

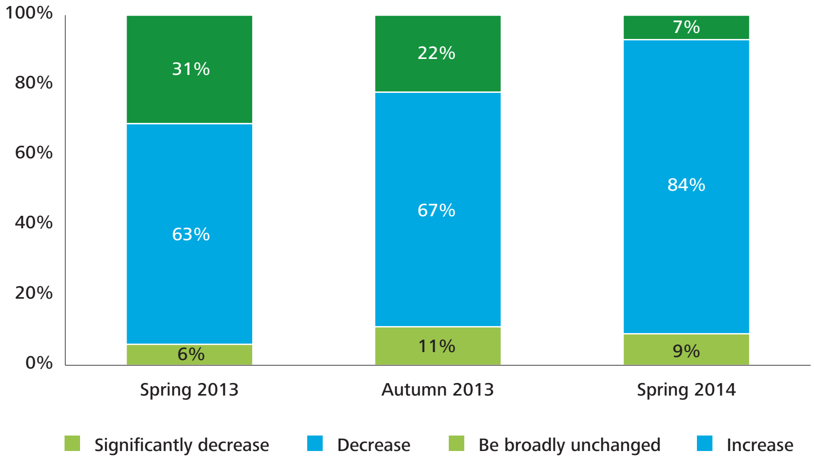
What are the three main drivers of M&A activity for your sector in the next 12 months?

The return of private equity to the sector is now seen as a significantly more important driver of M&A activity. Reasons for this are varied but include: improved business performance, availability of debt and the need to deploy capital.

Portfolio rationalisation and the wider economic recovery are both seen as even more important than in the Autumn.

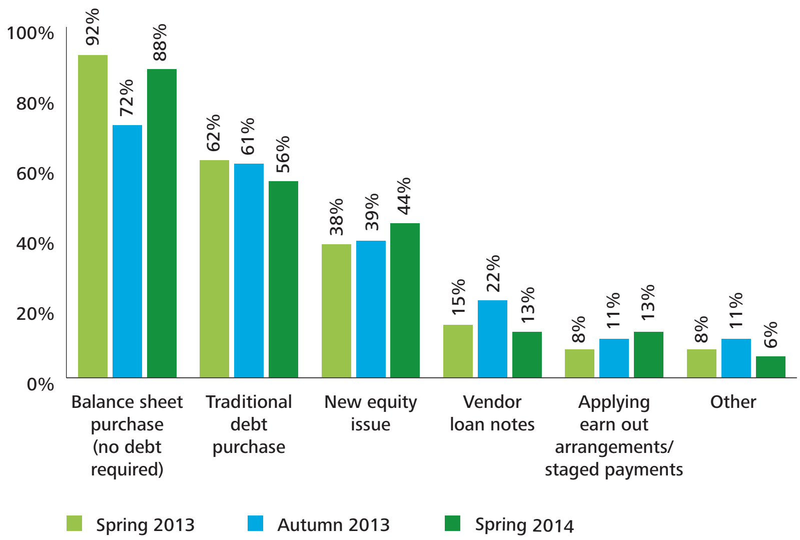


Deal multiples for companies in your sector in the next 12 months will:



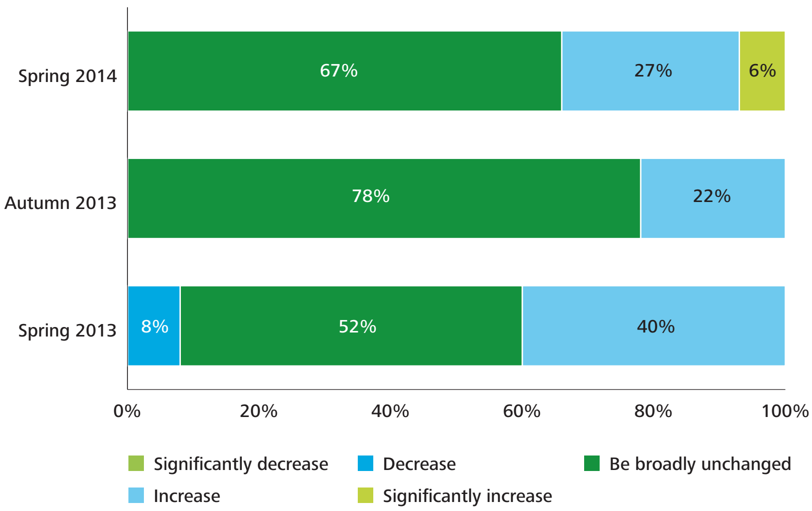
Although the majority continue to expect deal multiples to remain broadly unchanged, there has been a shift towards those anticipating an increase in the next 12 months.

What sources of deal finance will be most popular in your sector in the next 12 months?



Interestingly, the relative importance of sources of finance has not changed significantly since Spring 2013, with cash and debt purchases remaining the most popular route. However, businesses appear to be more willing to deploy the available firepower as confidence grows.

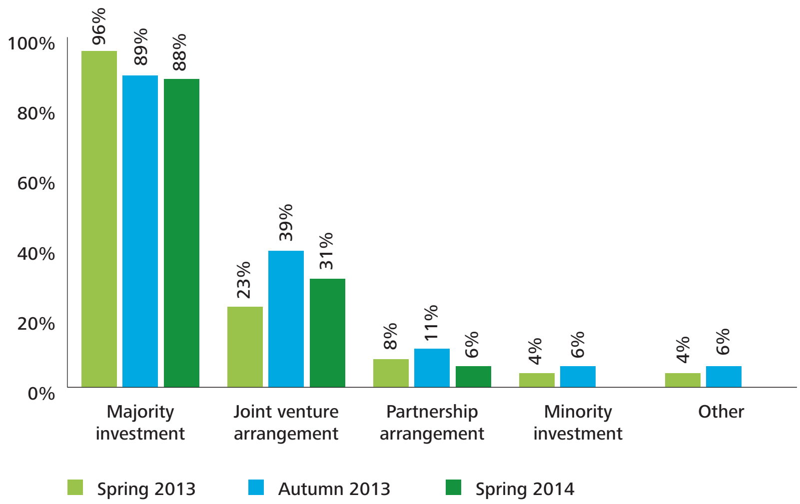
Availability of debt finance for deals in your sector in the next 12 months will:



CFO's responding to The Deloitte CFO Survey 2014 Q1 are reporting credit as being cheaper and more easily available than at any time in the last six-and-a-half years. This is supported by the results from our own survey, with respondents expecting that the availability of debt will continue to be excellent going forward and some even anticipating a further improvement.

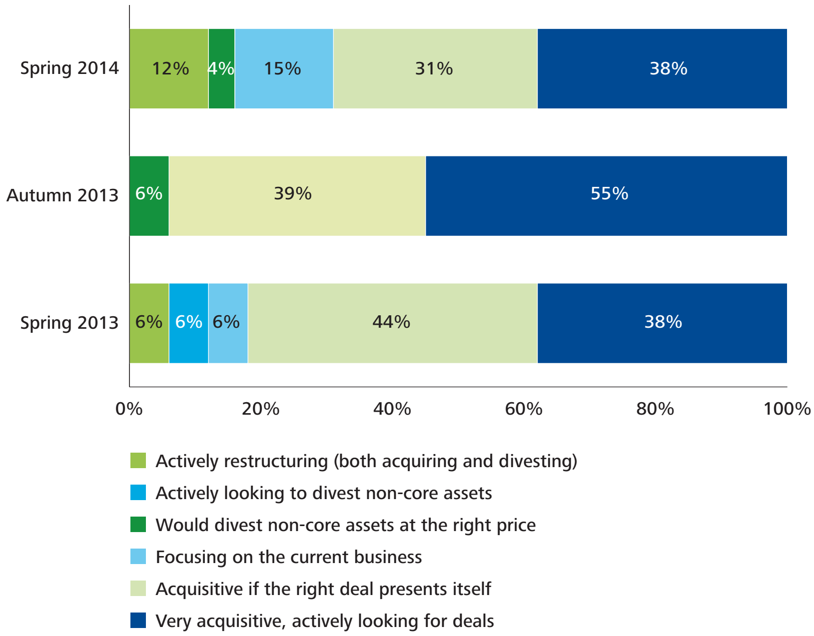
Strategy and origination

In your view, what will be the most popular investment strategy in your sector in the next 12 months?



Our survey respondents continue to prefer majority investments far above any other investment strategy, though joint ventures do represent a significant minority.

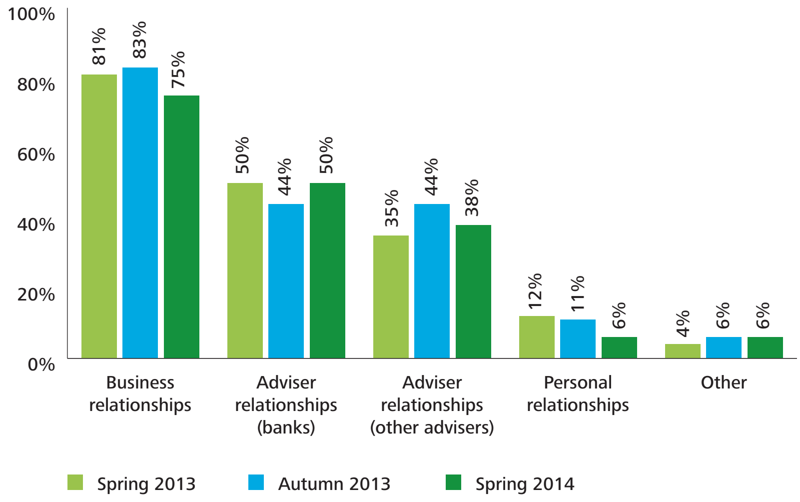
What is your current M&A strategy?



A clear majority 69 per cent of respondents remain acquisitive.

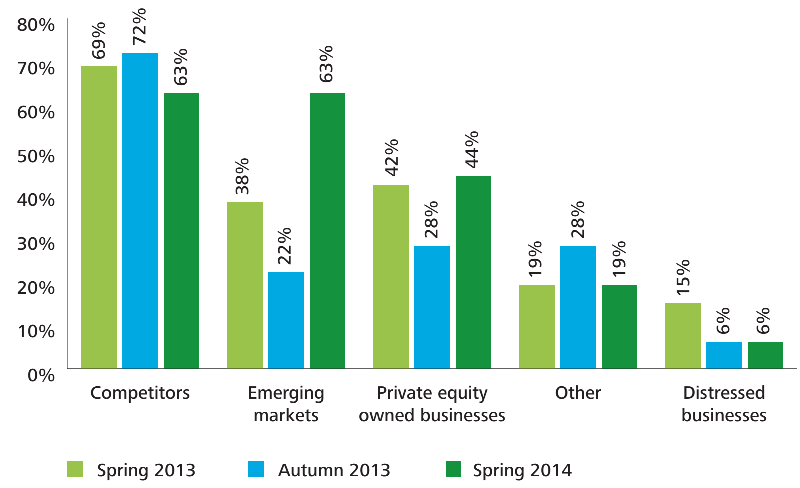
Consistent with our findings on the main drivers of M&A activity, namely a focus on non-core assets and the existing portfolio, there has been a small movement towards broader M&A strategies.

Source of origination



There has been no significant change in sources of origination across the three surveys we have conducted, with direct business relationships providing much deal sourcing, while bank and non-bank advisor relationships are also deemed important.

Source of target business



Our survey respondents had an increased interest in emerging markets.

What we are seeing, however, is a return in appetite to more 'traditional' Western markets. It will be interesting to see how this trend develops over the next few surveys.

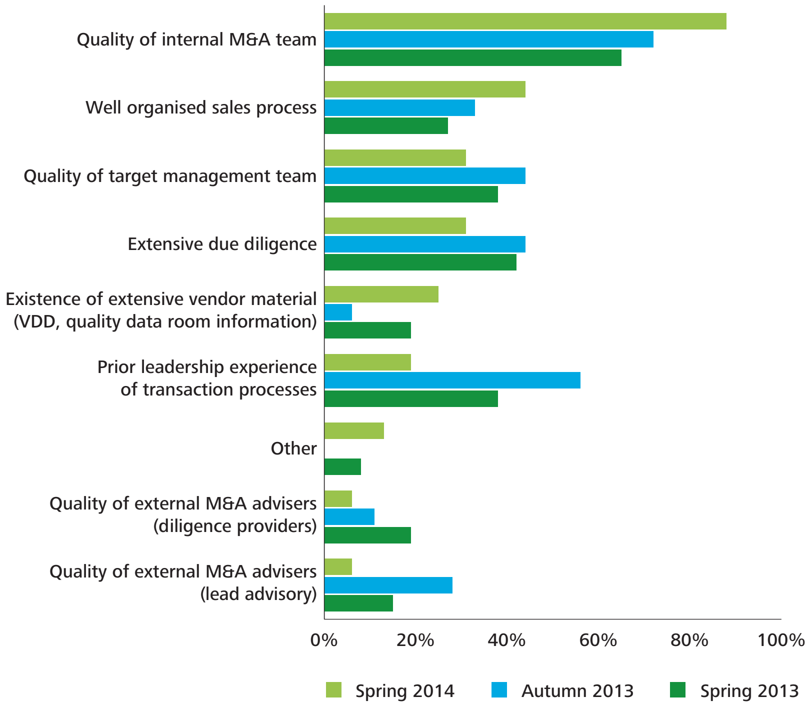
Private equity owned businesses are an increasing focus for our respondents.

M&A execution

The most important factor identified by our respondents continues to be the quality of internal M&A team!

Other success factors that have increased in importance are a well organised sales process and preparation of sell side materials to ensure a smooth process. Is this a reflection of more structured sales processes in the market as volumes increase?

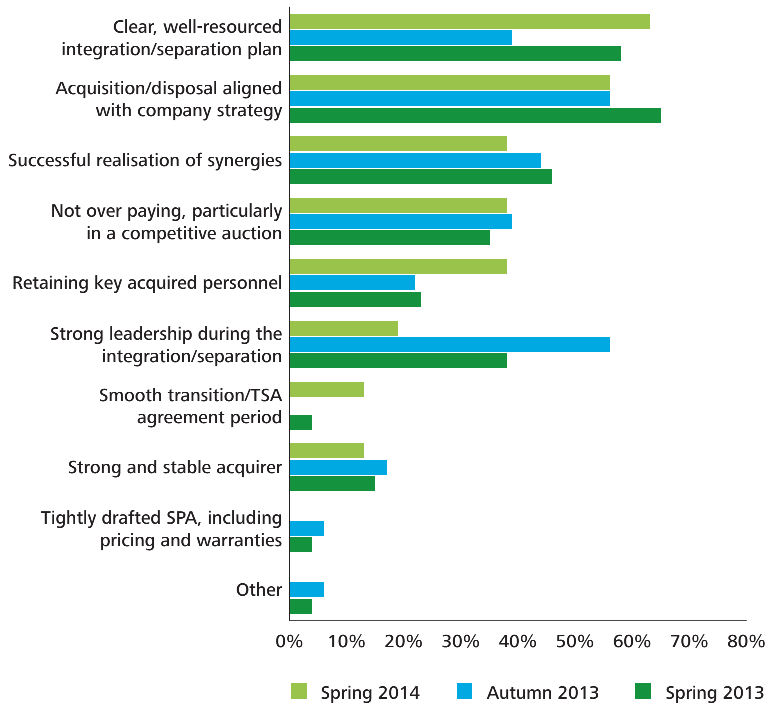
Drawing on your experience, please name the most important success factors in executing a transaction



Our respondents continue to take a long term approach when considering whether or not a transaction is a success:

- A clear and well resourced integration/ separation plan is now seen as the most important factor; and
- Retaining key acquired personnel has become more significant.

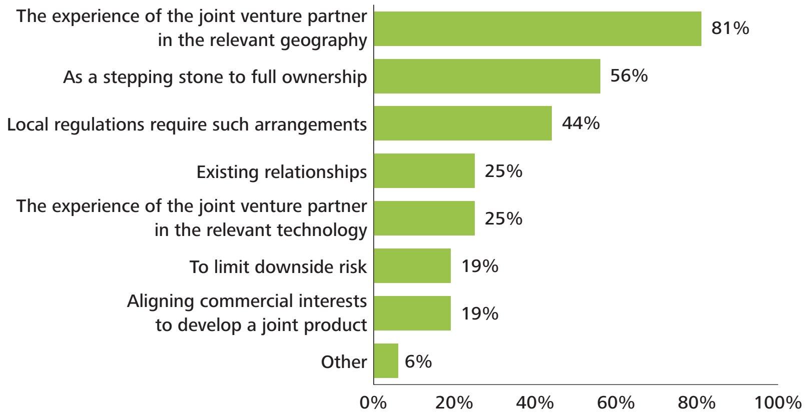
Drawing on your experience, please name the factors which most underpin a successful transaction



Joint ventures

For this edition we have particularly focused on the experience of our respondents in joint ventures. As businesses continue to look at expanding into new geographies, joint ventures are a common transaction structure.

Please select what you would consider to be the three primary reasons for entering a joint venture arrangement

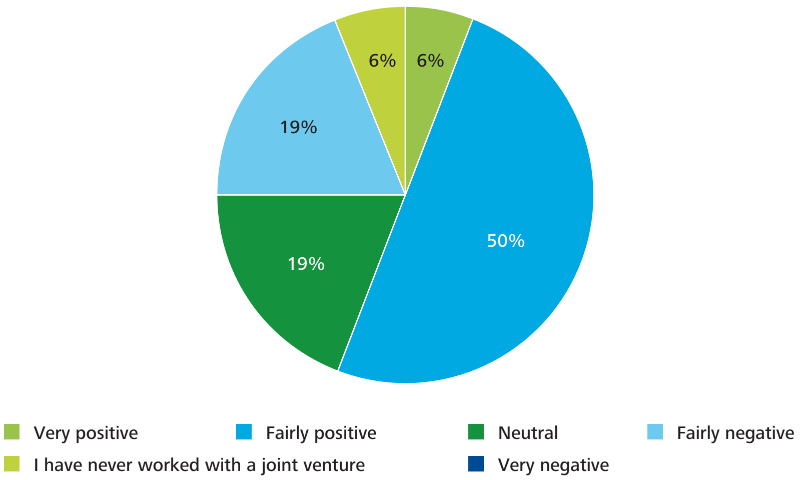


As noted previously, majority investment is the firm preference of our respondents. However, commercial imperatives or regulatory requirements often drive the need for joint ventures.

Experience in the relevant geography was identified by 81 per cent of respondents as a primary reason for a joint venture.

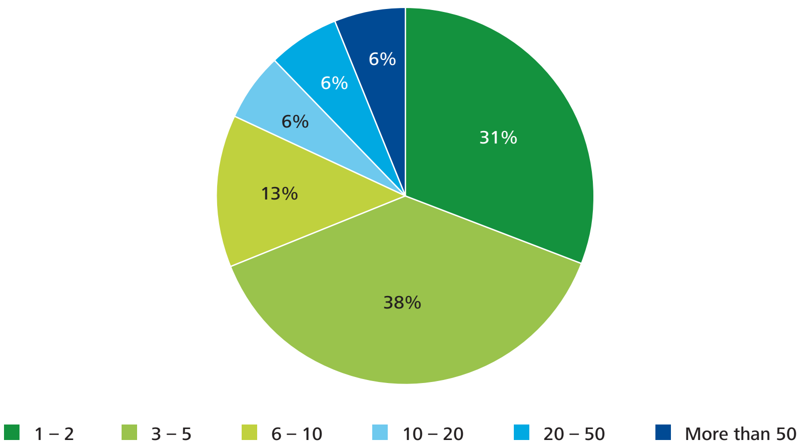
The requirement for a local partner was only around half as important a reason for entering into a joint venture (44 per cent).

How would you categorise your experience of working with joint ventures?



56 per cent of respondents are positive or very positive about their experience of joint ventures though a significant minority are fairly negative.

Approximately how many joint ventures does your company operate?



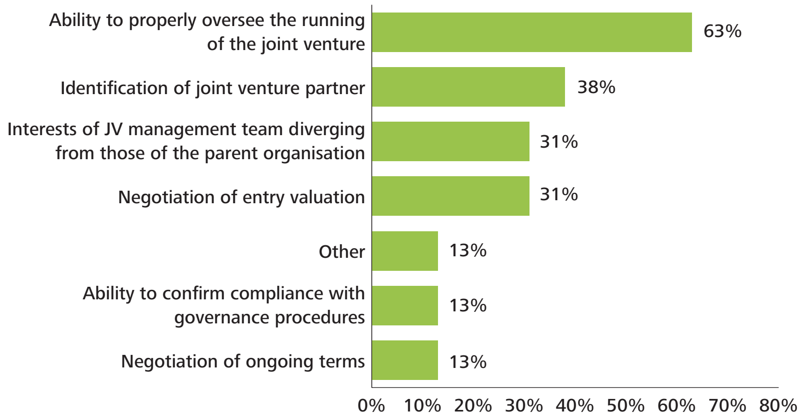
Over two thirds of respondents operate at least three joint ventures, while 18 per cent operate ten or more, demonstrating a wide range of experience with this transaction structure.

Our respondents identified two challenges as being of most importance:

- Overseeing the running of the joint venture once it is operational; and
- The negotiation of exit options.

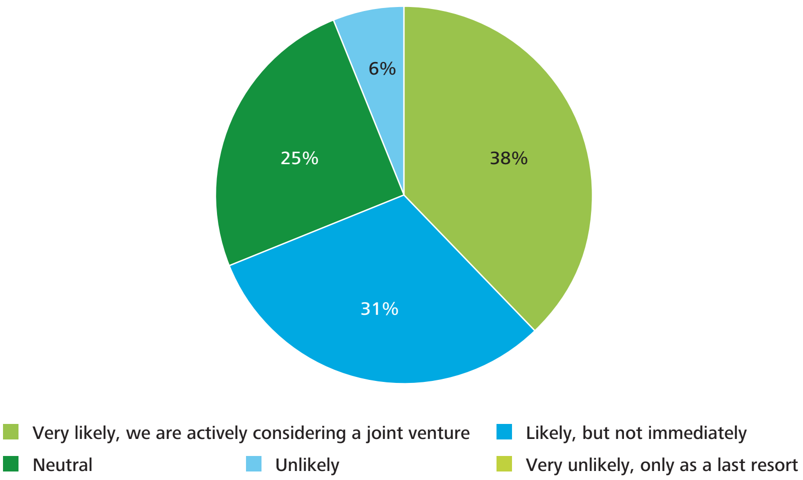
This is consistent with our experience of the difficulties encountered during joint venture negotiations.

Please identify the three most important challenges to overcome when entering a joint venture arrangement:



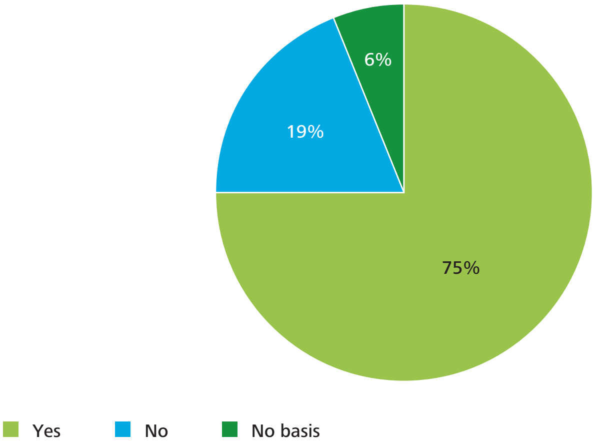
Despite the challenges, 69 per cent of respondents are likely or very likely to enter into a new joint venture, underlying the importance of this transaction structure within the deal landscape.

What is the likelihood of you/your company entering a new joint venture arrangement?



A majority of respondents believe that the joint ventures they have been involved in should be seen as a success, though a significant minority deem them to be unsuccessful.

In your personal experience, have joint venture arrangements added value/been successful?



Our Manufacturing and Industrials M&A Specialists

Our team of M&A experts across the firm have extensive experience in providing innovative industry specific solutions to the Manufacturing and Industrials Industry. If you would like to discuss any of the findings in this publication or find out more about our services to the Manufacturing and Industrials industry, please contact one of the specialists listed below:

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About the Deloitte UK Manufacturing and Industrials M&A Predictions

The Deloitte UK Manufacturing and Industrials M&A Predictions is a biannual summary of the views of CEOs, CFOs and M&A Directors of UK and European Manufacturing and Industrial companies (publicly listed, or private UK businesses).

The Deloitte UK Manufacturing and Industrial M&A Predictions gauges forward-looking expectations for M&A and the capital markets. The survey took place between 20 March and 30 April 2014.

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Designed and produced by The Creative Studio at Deloitte, London. 35128A